THREE ESSAYS ON INSTITUTIONALISM AND ECONOMIC DEVELOPMENT

by

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ABSTRACT

The state of the economics discipline has been in crisis for decades, and the shortcomings of mainstream economic theorizing brought to general attention. However, orthodox policy advice still dominates in policy-making arenas, and heterodox economists are too readily dismissed in an age that can properly be called the return of "vulgar economics." It will be argued that the heterodox "challenge" to the current economic climate must be two-pronged, involving both a sound critique of mainstream economics in terms of internal consistency and empirical evaluation of policy outcomes, and offer a clear, cogent foundation from which a multitude of political viewpoints and heterodox theories can proceed. This dissertation first takes up the latter charge by pointing to one such broadly unifying foundation already evident in much of the heterodox literature, specifically in the Marxist and Veblenian Institutionalist schools of thought. Once clarified, this dissertation then begins the work of the first task by critically examining orthodox economic theory, particularly in development policy-making and advice. Finally, a call is made for recognition of commonality already underpinning the various heterodox views of economic life. It is suggested that future research incorporates the Institutionalism – as outlined here – into the Classical-Keynesian framework, so that it is firmly rooted within an existing theoretical structure capable of encompassing differing particular economic viewpoints. It is argued that this would bring into clear focus the heterodox position that sees the study of power relations as the basis for sound economic analysis and policy-making.

This dissertation is dedicated to Matias, my professor and mentor; my sister, Miriam, and "sister- from-another-mother," Rachel; and my husband, Richard, whose support, encouragement, and unwavering patience as I pursued this degree and through lengthy and unprompted monologues on the essential nature of everything has surely guaranteed him sainthood.

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INTRODUCTION

The economics discipline has been in a state of crisis for decades. The crisis is perhaps most widely visible in the policy-making arena, where it has been particularly evident over the last decade and in the aftermath of the 2007 “Great Recession.” As any teacher of economics to undergraduate students can attest, explaining U.S. policy decisions with lucid and consistent economic models in recent decades is a formidable task. The neoclassical orthodoxy has been guiding policy for decades, but policy decisions are often inexplicable when attempting to employ their own models, much less with consistency to the underlying assumptions. This is where the teacher and scholar is left explaining political objectives, targeted loosely through mainstream economic models in support of these objectives in an ad hoc fashion. Consequently, heterodox economists are often derided and dismissed by the mainstream of the discipline for being overly guided by their political value systems. Even for students introduced to both heterodox and mainstream approaches in their undergraduate studies, many are left concluding, at best, that “pluralism” (appropriate economic analysis employs different models and approaches for different problems) is the best way to undertake economic analysis, and, at worst, that neoclassical economics has detached itself from political values, making it a “true” science, while heterodox economics has failed to do so.

Economic orthodoxy enjoys the position of reflecting the status quo, giving it the appearance of unbiased investigation. Leaving aside the issue of whether or not it is possible (or even desirable) to detach preanalytic vision entirely from academic work,[1] for those working outside the mainstream of economics this is by no means a new challenge, or a new topic of examination in the literature. The strength and longevity of this challenge through a major economic crisis only underscores how critical it is that this perception of heterodoxy continue to be addressed and relentlessly challenged. Moreover, as Bortis (1997) and various authors have pointed out, specialization and compartmentalization of economic theory has been rapidly increasing, such that economics is today “a divided science.” This poses an additional stumbling block for heterodox economists in that neoclassical economics is the dominant paradigm, so that the “specialization and diversification take place exclusively on the basis of one approach” (p. xii).

This dissertation sees the heterodox challenge as a two-pronged task: (a) a clear critique of the dominant paradigm in terms of internal consistency and empirical evaluation of policy outcomes and (b) a clear, cogent foundation from which a multitude of political viewpoints and various heterodox theories can proceed. This dissertation first takes up the latter by pointing to one such broadly unifying foundation already evident in much of the heterodox literature. Once this approach is clarified, this dissertation then begins the work of the first task by critically examining the mainstream of economics,

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[1] This follows Schumpeter’s use of the term “preanalytic vision” in *History of Economic Analysis*. As he explains,“[In] order to be able to posit to ourselves any problems at all, we should first have to visualize a distinct set of coherent phenomena as a worthwhile object of our analytic effort. In other words, analytic effort is of necessity preceded by a preanalytic cognitive act that supplies the raw material for the analytic effort” (1954, p. 41).

particularly in the arena of development policy, concluding with a suggestion for future research that formally incorporates the Institutionalism outlined here into a Classical-Keynesian framework.

One way this dissertation proposes that heterodoxy strengthen its position amongst competing approaches to the study of economics, is in first recognizing an already existent common underlying Institutionalist vision of economic life, which it is argued, is most clearly expressed in the works of Karl Marx and Thorstein Veblen in the history of economic thought.[2] It is reasonable to suggest that most heterodox economists agree that capitalism is a unique economic system, and that the primary premise of human history is production for the means of life, and therefore the production of material life itself. As such, there are certain universal qualities that all modes of production share (i.e., production, distribution, and exchange.) On the other hand, these qualities take on particular forms in each historical epoch, as for example, in Karl Polanyi's rendering of economic systems that organize production and distribution on some combination of principles, the functioning of which is ensured by correspondent patterns. This historical viewpoint is outlined in his well-known *The*

[2] Though, of course, numerous scholars abound throughout the history of economic thought in the present day who have maintained, formalized, and extended this economic tradition brilliantly so that it corresponds to the material conditions of a more advanced capitalist mode of production. Although Ha-Joon Chang is explored as one such economist in the second essay of this dissertation, the concluding section of this dissertation will revisit this topic as a suggestion for a classical-Keynesian framework that has room for the institutional insight for a Marxist- Veblenian Institutionalism, as viewed in this dissertation.

Great Transformation.[3] These particular forms are manifest in appearances – that which is most immediately grasped and knowable, which also contain the less visible universal qualities within them.

The economist to have first clearly (however dense his presentation may have been) brought this into view was Marx, who revealed a dual nature of economic life. By activelyworking through and beyond the particular features as they present themselves in economic life, Marx demonstrates that it is possible to arrive at also the universal features of an economic system, providing a deep understanding of the capitalist mode of production. In taking this approach, he was able to uncover the false (inverted) reality capitalism conveys to human subjects, and which so confounds neoclassical economics. It is argued in this dissertation that Veblen takes a quite similar approach and seems to share this underlying vision of economic life. This view supports much of the Radical Institutionalist literature that aims at restoring the radical elements of Veblen, and demonstrates that the distinctions made in the literature between Marxand Veblen have been greatly overstated.[4] It is hoped that this dissertation will contribute to the Radical Institutionalist project by pointing to a similarity in approach to economic investigation that suggests an underlying essentialism in both authors. It is proposed in this dissertation that economists simply call this shared vision of economic life "Institutionalism," however ambiguous that

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[3] See especially chapters 4-5 for a presentation of the principles and patterns. Moreover, chapter 6 on the fiction of the self-regulating market demonstrates an Institutional underpinning that complements the presentation of Institutionalism in this dissertation.

[4] As for example, in William Dugger's words, the project is to "[R]estore the whole Veblen. Put the red threads back into him and turn Veblen the Eccentric into Veblen the Red" (Dugger, 2006, p. 261)

term has become, as a reclaiming of a Veblenian Institutionalism in a mass of economic literature that stamps this label on any work that makes mention of institutions.[5]

Another reason for choosing these two authors in particular is that it is no mistake they have both extraordinarily and powerfully influenced the economics discipline in general with their respective abilities to see through the free market fiction and lay bare a system replete with conflict, while make hard hitting criticisms of the economics discipline itself. This influence is evident even in the form of polemically formed models and arguments in support of the marginalist exchange-based approach, generally referred to as neoclassical economics in this dissertation. Those economists who have extended the respective works of Marx and Veblen have similarly helped bring clarity into the economics discipline within an evolving and more advanced capitalist world-system. This, it is argued, is because both Marx and Veblen are Institutionalists, as it is defined in this dissertation, even though neither author applied this term to their own work. There is, unfortunately from the viewpoint of this dissertation, more debate and less cohesion between the disciples of these two authors than a first glance at the conclusions and basic understanding of capitalism in their works would suggest in to a student of economics. The rift between Marxist and Veblenian Institutionalists is certainly not the only fissure within heterodoxy, but given that most heterodox economists proceed from an Institutionalist framework for capitalism that it

[5] There is a similar ambiguity in the use of the term "Political Economy." An examination of the difference between two distinct approaches to economic investigation that both lay claim to this term is, however, beyond the scope of the present work but rests largely on the same distinction made in the second essay between New Institutional Economics (NIE) and Old Institutional Economics (OIE).

is so evident in the works of these two authors, it seems sensible to begin with a reconciliation in this literature before extending it to other "schools" of thought.

After making a case for a broadly reconciled Marxist-Veblenian Institutionalism, another way this dissertation aims to help outline a unifying vision in heterodoxy is in clarifying the term "Institutionalism" and examining the present state of Institutional economics, particularly in the field of development economics where it is most commonly found. It can be fairly said that the classical political economists were largely "development economists,"[6] in the sense that they were concerned with the growth and reproduction of the system, generally from the viewpoint of the "surplus approach."[7] Since this dissertation proceeds from the viewpoint of political economy (a view to understanding the development and growth of capitalism, which is coexistent with the development of economics itself – both heterodox and orthodox), the study of capitalism cannot be separated from the study of institutions. The mere introduction of institutions into existing neoclassical models is not a sufficient means of understanding the way capitalism functions, and concurrently fails to function as the best allocator of resources. Institutions, particularly as manifested in mode of production-specific power

[6] See, for example, "The Pioneers of Development Economics: Great Economists on Development." In the Introduction to this 2005 collection of works Jomo K.S. states that "[T]he way forward for development economics…must build on the many heterodox economic legacies that have contributed valuable insights which development economics has built upon. And the enduring contributions of the early development economists are decidedly heterodox in nature. Hence, rather than encourage developments to be 'domesticated' and 'rehabilitated' by the orthodox mainstream, the economics of development needs to be recognized as offering a superior mode of economic analysis..." (KS, Jomo, 2005, p. xiii).

[7] See Garegnani (1984) for a summary of the main tenets of the classical surplus approach, and the concluding section of this dissertation for a brief discussion of its compatibility with the foundational Institutionalism proposed in this dissertation

relations, underpin and are the contextual basis of capitalism. They are not merely distinct variables among the "players" of the competition for scarce resources game, or "obstacles" to achieving market efficiency a many so-called Institutionalist authors have it. The analysis of heterodox economists, like most of the great classical authors, proceeds from a firm grounding in a historical study of economic systems up to and including capitalism, necessitating an investigation of the political and legal systems of each epoch. In this way, heterodox economists understand institutions as critical to understanding the present economic system, and do not attempt to create a fictitious world of unfettered markets over which institutions are superimposed to see how this fictitious world might be provoked, for better or worse, as perceived by the practitioner. This clarification of the term Institutionalism contributes also to the first task of strengthening heterodoxy's position in the economics discipline, as it also contains a critique of mainstream Institutionalist models and policy advice.

A third way this dissertation aims to meet the challenge of bolstering heterodoxy's relative position in economics is through a direct critique of neoclassical theory and empirical policy results over the last decades. Specifically, this dissertation hopes to establish what is best described in Marx's words as the revenge of "vulgar economics." It will be argued that mainstream policy over the last decades has been guided less by orthodox economic models and more by political objectives that accord with the interests of the elites. For some neoclassical practitioners this is undeniably purposeful – done to advance their careers and earnings. Other, well-intentioned, sharp neoclassical economists are simply misguided by an approach to economics that provides little by way of understanding the essential nature of the existing mode of production, limiting their ability to effectively make policy that achieves desired and predicted results.[8] As stated early on, this dissertation hopes to make a contribution toward a change in the terms of the debate heterodox economists have long been having with neoclassical economists.[9] Part of this undertaking necessarily involves a look into the history of the economics discipline itself. Even though the so-called "marginalist revolution" and formalization of "exchange- theories"[10] is undoubtedly relevant to this story, much has been written on this matter and is not the focus of this dissertation. Instead, capital debates will be made a point of focus in the history of economics that helped steer the orthodoxy in the direction of vulgar economics at the same time free-market fanaticism grew in the policy arena.[11] The International Monetary Fund (IMF), an institution dedicated to economic policy and empirical research attuned to the mainstream of the profession, and one of the most powerful financial institutions in the world, is used as a

[8] See the second essay in this dissertation for examples of such "Institutional" economic thinkers.

[9] This dissertation presupposes that an uncompromising debate as heterodox economists, rather than acquiescence with the mainstream, is both desirable and necessary for the well-being of the capitalist world-system. For a discussion of this viewpoint in the context of Colander, Holt, and Rosser's provocative 2007 piece, see Vernengo (2010).

[10] This follows the terminology of Hunt and Lautzenheiser (2011) and Pasinetti (1977), and is used in contrast to the "production approach" of the classical authors to economic theorizing.

[11] Although it will be made clear in the second essay of this dissertation (which explores Veblen's theory of institutions in more depth than the first essay), it is perhaps worth mentioning at this point, for clarity's sake, that the economics discipline is itself an institution, in that it is an organized system of "custom and habits of thought" as Veblen had it. Veblen's approach (as Marx's) involves a two-way street, so to speak, between institutions and individuals, which is to say between historically inherited material conditions and human subjectivity within this context, generally discussed as

case study of the confusion the capital debates forced on neoclassical economics. This is of particular interest following the 2007 crisis, in which many heterodox economists hoped that a significant change in economic theory and policy-making may take place.

To meet these goals, the remainder of this dissertation is organized into three essays, followed by concluding remarks. The first of these essays, "Institutionalism: A Marxist- Veblenian Basis," maintains that as the Radical Institutionalist literature attests, in spite of methodological differences, Marx and Veblen draw strikingly similar conclusions regarding production, conflict, and alienation in modern life. This essay attempts to add a new dimension to this viewpoint by establishing that similarity in conclusion stems from similarity in approach. After briefly reviewing some of the Radical Institutionalist literature, Marx's method is examined, making the mediated starting point the focal point of examination. Veblen's own approach to analysis in *The Theory of Business Enterprise,* and the conclusions that emerge as they resemble those of Marx, will then be presented. It is concluded in this essay that in taking a kindred approach, Veblen is able to arrive at an understanding of capitalism in accordance with, and complementary to, Marx's rendering of the inverted nature of economic life in modernity. This viewpoint, it is argued, is the very basis of Institutionalism.

The second essay, titled "The Veblenian Roots of Institutional Political Economy," looks specifically at the usage of the term "Institutional Economics," which

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"cumulative" or "recursive" causation. Consistent with this viewpoint, it is not being argued in this dissertation that a change in economic theory causes a direct, linear change on the historical development of capitalism. Rather, the capital debates are an important part, in tandem with the development of capitalism, toward a more liberalized capitalism and theory. In short, it is a two-way street between influential economic ideas and existing historical, material conditions.

has been applied to some of capitalism's strongest critics as well as its most ardent apologists. In examining the roots of Institutional economics, this essay attempts to disentangle the ambiguity surrounding this label. The Institutional Political Economy of Ha-Joon Chang is then examined as a return to Institutionalism's radical roots in development economics. Concluding remarks suggest that this approach is capable of encompassing gender as an analytical category, an extension that would improve the ability of policy makers to assess the impacts of macroeconomic policy.

The third and final essay, "The Capital Debates and Mainstream Policy Advice: A Case Study," is coauthored with Matias Vernengo. Here we argue that the global crisis of 2007 has shown the limitations of the mainstream approach. We trace the origins of the limitations of the dominant neoclassical views to the capital debates and to the rise to dominance of intertemporal general equilibrium. We use the IMF as a case study of this perplexing continuity of policy advice. Given our survey, we conclude that even though the economy was in the midst of the worst capitalist crisis since the Great Depression, a significant paradigmatic shift in economics is extraordinarily unlikely.

Concluding remarks will follow, where it will be suggested that the analysis done in this dissertation lays the groundwork for the introduction of Institutionalism into the classical- Keynesian framework, an integration that would mutually strengthen these compatible and complementary approaches to the study of economic life. It will be argued that such a synthesis has the strength and potential to be the basis for heterodox approaches to economic investigation and policy-making, as it leaves space open for historical and institutional specificity and is compatible with different theories of investment, allowing debate and discussion to continue in a more productive way – with a common framework and language for more coherent discussion across differing viewpoints.

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INSTITUTIONALISM: A MARXIST-VEBLENIAN BASIS[1]

Abstract

As the Radical Institutionalist literature attests, in spite of methodological differences, Marx and Veblen draw strikingly similar conclusions regarding production, conflict, and alienation in modern life. An attempt is made here to contribute to this viewpoint by establishing that similarity in conclusion stems from similarity in approach. Marx's method will be briefly reviewed, making the mediated starting point the focus of discussion. From this vantage point, Veblen's own approach to analysis in *The Theory of Business Enterprise,* as well as the conclusions that emerge as they resemble those of Marx, are considered. It is concluded that in taking a kindred approach Veblen is able to arrive at an understanding of capitalism in accordance with, and complementary to, Marx's rendering of the inverted nature of economic life in modernity.

Introduction

For students working in the heterodox tradition of political economy, where the respective works of Karl Marx and Thorstein Veblen form part of the canon, numerous

[1] Portions of this essay have been reprinted from *Journal of Economic Issues* 46, no 3 (September 2012): 757—767. Used by permission of M.E. Sharpe, Inc.

ostensible parallels between the works of these authors present themselves. Despite this common intuitive supposition, even a cursory glance at the existing literature reveals little consensus. It would therefore be folly to think this century-long deliberation could be resolved here, in the context of the present paper; it is hoped merely to add a new dimension to the discussion. Here, it is maintained that the striking similarities that emerge in the analysis and conclusions of both thinkers follow from a commonality in method. It is not argued that methodologies of Marx and Veblen are, by any means, identical, or to deny distinctions between the two, but it is insisted, in line with the Radical Institutionalist literature, that the rift between them has been greatly overstated. Specifically, it is argued that a parallel can be drawn between Marx and Veblen in terms of their chosen starting points; a parallel only reinforced by their shared perception of the nature of economic life. Of course, the contention that one's point of departure influences the content of a work is a simple truism that would scarcely require proof. The objective here is to demonstrate that Veblen's chosen starting point in *The Theory of Business Enterprise* reveals a great deal about his essential methodology, much as Marx's choice to begin *Capital* with the simple commodity form is far from an arbitrary point of entry. Just as Marx's method served to demystify capitalism in approaching it from the standpoint of capital, beginning with the commonplace commodity, Veblen's choice in *The Theory of Business Enterprise* to proceed from a historically specific presupposition – the modern “business man” – allowed him to explore the specific character of modern capitalism from the viewpoint of business enterprise. In both cases, we are able to appreciate the inverted reality in which we live only by first adopting such a historically-mediated perspective.

It should be noted before this proposed Marx-Veblen accord proceeds that, as Ford and McColloch (2012) point out, much of the debate between these two "schools" regarding attempted reconciliation is largely based on Veblen's (1906) explicit commentary on Marx's system. They draw attention in their assessment of Veblen's reading of Marx's method to the circumstance that, along with his contemporaries, Marx's early works and the *Grundrisse* were not available to Veblen at the time of his writing this piece, so that his impression came primarily from the *Communist Manifesto* and his reading of *Capital's* first volume.[2] Consistent with the viewpoint of this paper, they contend, in line with E. K. Hunt,[3] that Veblen's damning of Marx's system as a "closed, teleological vision of history" stems more from Engels' rendering and popularization of Marx's system than to Marx himself (p. 768). In short, they conclude that at the core of the debate – whether or not Marx's dialectics suggest a historical *telos* – the Institutionalist literature that objects to a methodological reconciliation (as suggested in this paper and by Radical Institutionalist literature) is not supported with a passage where Marx implies that there will be a final end to history. Rather, he simply suggests that the capitalist system would be followed by determinant mode of production. They point to the work of Istavàn Mészàros (2005) who views the suggestion that the increasing immiseration of the proletariat should automatically bring about a new mode of production as a "fetishization of an economic relation."

[2] For a full discussion of the tension between Marxist's and Veblenian Institutionalist, as well as their response to Veblen's critique, the reader is referred to Ford and McColloch (2012, pp. 767-770).

[3] "As E.K. Hunt has noted, Marx himself never uses the term 'dialectical materialism.' Instead, dialectical materialism, conceived as an ontological description of matter in motion, is a conception owing wholly to Engels" (2012, p. 11).

In his words, "[e]conomic determinism as a historical hypothesis is a contradiction in terms because it implies the ultimate negation of history. If history means anything at all, it must be 'open-ended'" (Mészàros, 2005, p. 116; cited in Ford & McColloch, 2012, p. 770). As Ford and McColloch conclude, For Marx, humankind's objective freedom is constituted by the very lack of a singular teleological project in history. Human history is teleological only in the sense that it is a progressive realization of human essence; an essence which Marx (as Veblen) does not define *a priori* as either 'good' or 'bad.' (p. 770) A further examination of the topic of historical *telos* evident in the work of Veblen will be addressed later in this paper.

The remainder of this essay is divided into four sections. The first briefly reviews some of the contributions Radical Institutionalist have made in support of the argument that the dissonance between Marx and Veblen in much of the literature has been needlessly overstated. This will be followed by an examination of Marx's approach to investigation, bringing his mediated starting point to the center of focus and connecting this to an underlying essentialism in his viewpoint of economic life. The next section considers Veblen's *The Theory of Business Enterprise* in light of the parallel in starting point, drawing attention to similarity in terms of process, conclusion, and a compatible underlying vision of economic life. Concluding remarks underscore the significance of these starting points and associated essentialist conceptions of economic life to the outcome of economic analysis.

Radical Institutionalism

The Radical Institutionalist literature has long maintained that the discord between Marxists and Veblenian Institutionalists is counterproductive. One valuable contribution to this literature is found in Dugger and Sherman (2000). They point out that such "open-endedness," as discussed above, is inherently radical, and is a point of intersection between Marx and Veblen from the viewpoint of evolutionary theory.[4] In their view, Marx and Veblen are seen to have both presented properly radical theories of evolution. As they put it, "Evolution tells us a very radical story about human institutions. It tells us that what *is*, was not. Furthermore, it tells us that what is, will not be forever" (2000, p. 8). They critique both the uncritical Marxist view that assumes inevitable historical advancement to socialism, and the "moderate" or "liberal" Institutionalist lines of thought that suggest automatic and virtually seamless social and technological progress in evolutionary fashion, highlighting the fact that the two schools of thought are not so neatly demarcated by their views on social advancement and development. They maintain that Marx was the earliest social scientist in the 19th century to display a theory of evolution, which includes incremental change as well as revolutionary change. As they explain, Marxists point to conflict and power relations in the class system, whereas Institutionalists point similarly to the power of vested interests. Their principle concern is that the theory of evolution has been used as a "conservative weapon," in the sense that liberal, or moderate, Institutionalists tend to see change as rarely taking place through conflict or revolution, whereas "The theory of social

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[4] Although they differ from the essentialist view taken here in connecting this lack of a singular teleological project in history in both Marx and Veblen to their rejection of "something unchanging called human nature."

evolution, as both Veblen and Marx originally used it, was quite subversive" (p. 4). They call this return to the radical elements in Veblen's theory of evolutionary social change in the literature "the new Veblenian radical institutionalism." This viewpoint is perhaps best expressed in the passage below:

> Evolution happens because of the internal dynamics of society, not because of forces altogether outside of society – this is called endogenous change. Evolutionary change does not drop from the sky. And it is not directed from the sky. It is not the unfolding of a predetermined plan, divine or otherwise…[this] means that evolution is not necessarily progress. It is not necessarily the moving of humanity toward some level of existence deemed in some way to be better or higher than any previous level. Evolution does not preclude progress. But evolution itself is not necessarily progress; it is simply change caused by internal dynamics. The two may or may not coincide. (p. 8)

As addressed above in the work of Ford and McColloch (2012), this view of change not necessarily leading to a "better" system is present in the works of both Marx and Veblen, although it would seem that the hope of these two authors was to point out a conflict inherent to the existing mode of production in which evolution could occur in a way that would afford humans a system more in accord with their essential nature, to be more fully discussed below.

In another constructive contribution to the Radical Institutionalist literature, Philip O'Hara (2000) speaks to the issue of teleology in Marx and Veblen. He makes the distinction between strong and weak forms of teleology, concluding that Veblen was correct in rejecting strong forms of teleology in Marx's system. These forms are visible in the supposition that capitalism would, by design, turn out a privileged subject-object of history (the proletariat) alone capable of transcending capitalism. O'Hara argues that because the existing literature has tended to focus on Veblen's critique of strong forms of teleology, it has overlooked the weak forms of teleology in Veblen's system (Ford &

McColloch, 2012). Indeed, in *The Instinct of Workmanship and the State of the Industrial Arts,* Veblen explains that, "[A]ll instinctive action is teleological. It involves holding to a purpose. It aims to achieve some end and involves some degree of intelligent faculty to compass the instinctively given purpose, under surveillance of the instinctive proclivity that prompts the action" (1914/1990, p. 31). He discusses the instinct of workmanship, closely tied to the parental bent, as chief among the instincts in its intelligent, purposeful aim for the material well-being of the human race:

> The sense of workmanship is like all human instincts in the respect that when the occasion offers, the agent moved by its impulse not only runs through a sequence of actions suitable to the instinctive end, but he is also given to dwelling, more or less sentimentally, on the objects and activities about which his attention is engaged by the promptings of this instinctive propensity. In so far as he is moved by the instinct of workmanship man contemplates the objects with which he comes in contact from the point of view of the relevancy to ulterior results, their aptitude for taking effect in a consequential outcome. (1914/1990, p. 53)

As pointed out in Ford and McColloch (2012), Veblen recognizes that the labor process itself is a teleological projection into the future. As Veblen says in "The Instinct of Workmanship and the Irksomeness of Labor,"

> [Man] is possessed of a discriminating sense of purpose...It is to his proclivity for turning the material means of life to account that he owes his position as lord of creation. It is not a proclivity to effort, but to achievement- to the compassing of an end. (1898, pp. 188-189)

Beyond this shared conception of labor, weak teleological formulations are also visible in Veblen's theory of instincts. As William Dugger (2006) noted, Veblen was deeply critical of the essentialism of neoclassical economics wherein human beings are conceived as competitive and individualistic by nature. These attacks on essentialism should not, however, lead us to conclude that essentialism played no role in Veblen's own system. Veblen (1898) seems to argue that a cooperative social instinct, although often obscured or overshadowed by institutionally conditioned patterns of behavior, does constitute the essence of human nature.[5] [See also Stanfield (1989) for a discussion of essence and "becoming" in Veblen and Marx.] Veblen's conception of the instinct of workmanship is itself an end-oriented teleological projection. Modern society continues to realize technological progress, despite the sabotage of managers and absentee owners, because the instinct of workmanship is still manifest in a particular class. Seen in this light, what Veblen stridently rejects in Marx is the notion that any historical change in the organization of production is *necessarily* progressive. As we see below, this position does not prevent Veblen from affording a potentially revolutionary role to the engineers in modern society. The engineers are a potentially progressive force in history precisely because they are the modern expression of what is essential to humankind: the instinct of workmanship. This, of course, does not imply that the modern industrial system will crumble by the force of historical necessity. What it illustrates is that, much as in Marx, weak teleologies of this sort are basic constituents of Veblen's method.

Marx's Process

As Cline, McColloch, and Ford (2011) have argued, in rejecting the idealist dimensions of Hegel's dialectic, Marx implicitly reclaims the materialist dimensions of Aristotle's system. In particular, they demonstrate that Aristotle's mediated starting point is seen to resonate in Marx's method and to inform his decision to make the commodity the point of departure in *Capital.* As Book 1 of *Vol. 1* famously begins: "The wealth

[5] As Dugger has it, for Veblen "within the human breast beat an ancient anarchist/socialist heart" (2006, p. 659).

of those societies in which the capitalist mode of production prevails, presents itself as an 'immense accumulation of commodities,' its unit being a single commodity. Our investigation must therefore begin with the analysis of a commodity" (Marx, 1887/1992, p. 43). Marx then proceeds to consider capitalism from the viewpoint and logic of this commodity, in the quest to discover how profits and surplus value arise in competitive capitalism characterized by equal exchange. As is well known, his examination requires that after exhausting the possible scenarios in the "noisy sphere" of simple circulation, that which is most immediately visible, "where everything takes place on the surface and in view of all men," he moves beyond the realm of immediate appearances and "into the hidden abode of production" (Marx, 1887/1992, p. 172)[6] in order to uncover the essential nature of capitalism.

The purpose at present is to extend and direct this premise to the mediated starting point as it suggests an underlying essentialism in both Marx and Veblen. It is here argued that this essentialism underpins the similarity in these two authors' conceptions of modern life and critiques of the capitalist mode of production, in spite of certain methodological differences. In order to illustrate this parallel, this paper now begins with a review of Marx's basis for beginning analysis from presupposition.

As has just been noted, in examining capitalism's historically specific features, Marx proceeds from appearance, or that which is most immediately knowable to *us*. Once the apparent facts are established he moves beyond historical specificities in

[6] As Cline, McColloch, and Ford point out, "The starting point of actually existing appearances not only separates Marx from Hegel, but separates him from both Smith and Ricardo. While Smith and Ricardo begin with generalities (the division of labor and value itself respectively) Marx begins with a concrete appearance, the individual commodity" (2011, p. 14).

order to identify their essential nature, revealing what "greater" truths are contained in their existent form. Consistent with Hegel, Marx denies the subject-object split with his dialectic, but rejects the primacy Hegel's dialectic assigns to the object *in thought.* Accordingly, Marx critiques Hegel for painting history as the history of the "production" of abstract, or speculative thought (Marx, 2003). Marx considers this viewpoint to be the inevitable result of Hegel's failure to grasp the nature of his own alienation, the product of the alienation of modernity in general. As he says of Hegel's *Logic,* "*Logic is the* money of the mind, the speculative *thought-value* of man and nature, their essence indifferent to any real determinate character and thus unreal" (Marx, 2003, p. 174). Although he considers Hegel to have gone much further than previous philosophers in comprehending man's self-creation as a process and for arriving at a notion of alienation, he maintains that the ideal basis of Hegel's dialectic prevents him from understanding the essential reality of either. As he famously says in the "Afterward" to the second German edition of *Capital,*

> The mystification which the dialectic suffers in Hegel's hands, by no means prevents him from being the first to present its general form of working in a comprehensive and conscious manner. With him it is standing on its head. It must be turned right side up again, if you would discover the rational kernel within the mystical shell. (Marx, 1887/1992, p. 29)

His critique of Hegel is therefore essential in understanding his own method.

In the third manuscript of the *Economic and Philosophical Manuscripts,* Marx evaluates Hegel's *Phenomenology of Mind,* which he maintains to be the birthplace of Hegel's philosophy that also contains its "secret." For Marx, the "main point [of *Phenomenology*] is that the *object of consciousness* is nothing else but *self-consciousness,* that the object is only objectified self-consciousness, self-consciousness as an object" (Marx, 2003, p. 178). In this view – which takes *self-consciousness* to be *man* – the alienation of self-consciousness constitutes a (seemingly) independent substance, or "thinghood." Accordingly, objectivity is intrinsically alienated from human essence, which in order to be overcome, requires the supersession of the object *in thought.* Given that man's essence is objectified, reappropriation of his *objective being* surmounts both alienation and objectivity.[7] In the Introduction to the *Grundrisse,* Marx explains the "illusion" that so confounded Hegel, leading him to embrace this mystified view:

> [In] conceiving the real as the product of thought concentrating itself, proving its own depths, and unfolding itself out of itself, by itself, whereas the method of rising from the abstract to the concrete is only the way in which thought appropriates the concrete, reproduces it as the concrete in the mind. *But this is by no means the process by which the concrete itself comes into being.* (Marx, 1939/1993, p. 101, emphasis added)

Likewise, in Marx's *A Contribution to the Critique of Hegel's Philosophy of Right* he views Hegel's conception of the state – a manifestation of alienation in real human life, in the same way as is religion – as the result of his transformation of predicate into subject. Akin to Hegel's own notion of ideology as an abstraction that remains lodged in the predicate, as Colletti (1972) explains, Marx critiques Hegel for giving predicates autonomous existence, and then turning them into their subjects.[8] As a consequence, the genuine subject emerges as the result. "Precisely because Hegel starts

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[7] The latter because it is the objective nature of the object (as opposed to its determinant nature) "which is the scandal of alienation for self-consciousness." In this way, the object is "self-annulling" (Marx 2003, p. 184).

[8] As Colletti says, "Existence is not a predicate, it is not a concept. The conditions as a result of which something is given to us to be known are not to be confused with conditions as a result of which this something is taken up into thought" (Colletti 1972, p. 92).

from the predicates of the general description instead of from the [actual subject], and since, nevertheless, there has to be a bearer of the qualities, the mystical idea becomes this bearer" (Marx, 1970/2009, p. 24). Marx again here points to Hegel's error in mistaking the way in which nature presents itself to man as identical to the way in which the concrete actually comes into being.[9]

In this way, Hegel's philosophy bears mystification problems, wherein the finite is not real, and renders him unable to see that the infinite's *true subject* is the real finite. Thus, Hegel's philosophy is itself a manifestation of an inverted reality, is itself an expression of alienation in real, sensuous human life. Marx makes it clear that he believes the way to avoid falling into this deception is to proceed from the subject, and then perceive its objectification (Marx, 1970/2009).

It can now be argued that the core of Marx's critique of the Hegelian method lies in his chosen starting point, which is at the heart of the connection made in this paper between the approaches of Marx and Veblen. Hegel proceeds from pure Being in order to avoid being deceived by presupposition. In proceeding from the actual subject, rather than predicates divorced from their subject, Marx explicitly wishes to steer clear of this confusion. For Marx, deception occurs when proceeding without presupposition, and can only be circumvented in a process that proceeds from immediate phenomena grasped as such. In *The German Ideology* he clearly states this of his own method.

[9] Lucio Colletti is emphasizing this same point when he says, "Existence is not a predicate, it is not a concept. The conditions as a result of which something is given to us to be known are not to be confused with the conditions as a result of which this something is taken up into thought" (Colletti, 1973, p. 92).

> The method of approach is not devoid of premises. It starts out from the real premises and does not abandon them for a moment. Its premises are men, not in any fantastic isolation and rigidity, but in their actual, empirically perceptible process of development under definite conditions. (Marx and Engels, 1947/1970, p. 47-48)

Hence, as historical objective beings, we should begin inquiry with that which is most knowable and apparent to *us.* Method of inquiry, however, must not end here. Scholars must make an effort to work through and beyond these initial appearances, without ever fully dispensing of them, something that will also be shown to be evident in Veblen's approach to *Theory of Business Enterprise* below.

In contrast to the Hegelian world, in which the object has no objective existence outside of *knowing*[10] itself, for Marx, objects really exist, are external to humans, and are a basic precondition for the use of his human faculties. In this way, objects are both the prerequisite *and* the circumstance for historical human subjects to realize their basic nature. He takes as an example the hunger drive, which requires a nature outside of itself in order that it be satiated. From this viewpoint, if an *objective being* is to create an object, it need not "descend" from its "pure activity" à la Hegel, given that the object authenticates in its activity as an *objective being.* The activity of such a being is objective, precisely because objectivity is constituent of its essential being. In the famous example of the architect and the bee, Marx recognizes the object of the architect's laboras the substantiation of his activity as an *objective being.* It is therefore this laborer's potential, objectified by his own deliberation, and realized in the process of

[10] This is because for Hegel "the object is only the semblance of an object, a deception, which is intrinsically nothing but knowing itself which has confronted itself with itself, has established in face of itself a nullity, a 'something' which has no objective existence outside the knowing itself" (Marx, 2003, p. 184). Hence, an object arrives at existence for consciousness inasmuch as it knows it to be *something.*

building. At the same time, the essence of the house is brought into unity with its existence. Marx explains, "The fact that man is an *embodied*, living, real, sentient, objective being with natural powers, means that he has *real, sensuous objects* as the objects of his being, or that he can only express his being in real, sensuous objects" (Marx, 2003, p. 171). The primary premise of human history for Marx is production for the means of life, and therefore the production of material life itself (Marx, 1978).

At this point one word of caution should perhaps be made for the sake of clarity. Just as it is a mistake to interpret Hegel's idealism as the vulgar idealism of the philosophers he wished to critique, Marx's materialism must not be mistaken for those mechanistic forms of materialism that both preceded and followed him.[11] Although Marx pronounced Ludwig Feuerbach to be "the only person who has a serious and critical relation to Hegel's dialectic, who has made real discoveries in this field, and above all, who has vanquished the old philosophy," he was nonetheless careful to distinguish himself from this static materialism (Marx, 2003, p. 171). Marx explains that Feuerbach's insistence on grasping the existence of an object as independent from one's contemplation of it, he is left only able to grasp the sensuous world through a philosopher's "spectacles," ultimately preventing him from moving beyond that which is immediately knowable (Marx, 2003).[12]

[11] Marx demarcates his "naturalism or humanism" from both the methods of idealism and materialism, which he argued also "constitutes their unifying truth" (Marx, 2003, p. 181).

[12] Feuerbach saw his own approach as the negation of philosophy, the "incarnate result" of speculative philosophy which "puts an end to it by explaining it" (Feuerbach, 1989, p. xiv). In Marx's theses on Feuerbach in *The German Ideology*, he says of this method, "The object, reality, sensuousness is conceived only in the form of the

As is now clear, for Marx, for historical subjects, whose activity is constituent to our essential being, we must begin with such objects that are most clear and knowable to *us*. Marx's system owes its motion to the human activity of self-creation, a potential achievable through a nature that is outside of us, so that the fundamental nature of the world is sensuous movement of matter. As will be shown below, this is not dissimilar from Veblen's understanding of the objective world and human subjectivity.

Veblen's Process

As has been seen, the literature is rife with suggestions that despite certain theoretical and methodological differences between the work of Veblen and Marx, many of their conclusions regarding the operation of modern capitalism may ultimately be reconciled. Here there is little disagreement, and in view of this existing body of work the present objective is not to add another voice to the chorus. Though it is the view of this paper that a profitable Marx-Veblen synthesis could be achieved despite lingering tensions, the immediate purpose lies elsewhere (but a few representative examples of such efforts may be found in Dowd, 1974; Dugger & Sherman, 1994; O'Hara, 2000; Pluta & Leathers, 1978; Stanfield, 1989; Sweezy, 1958). Namely, it is contended that a striking methodological parallel can be drawn with respect to their choice of starting points.

It should be noted that the purpose of this essay is not to negate or assign a superficial role to Veblen's evolutionary approach. Following Sherman and Dugger

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object or of *contemplation* but not as *human sensuous activity, practice,* not subjectively" (Marx and Engels, 1947/2004, p. 121). Feuerbach's fundamental shortcoming for Marx is his belief that existence is one and the same with essence, and consequently leaves his disciples with a static materialism, taking what is as given.

(2000), evolutionary social theory is inherently subversive in its implications and features importantly in Veblen's view of change.[13] Rather, this essay situates his evolutionary approach within his own essentialism concerning human nature, where Veblen's work bears most fruit. For Veblen, what *is*, is not eternal, existent from time immemorial. The web of relations, material conditions, and institutional structures within which we carry on the life process has origin, sculpted in time and culture, constituting its present form. Accordingly, existence is in an unremitting state of change, and an understanding of the specific nature of modern economic life requires that *nothing* be taken as given. Indeed, as Veblen is quoted in Lekachman's Introduction to *The Theory of the Leisure Class*, "What *is*, is wrong" (Veblen, 1899/1994, p.viii).

Nevertheless, what *is,* is precisely where Veblen begins his examination of the "modern industrial system" in *The Theory of Business Enterprise*. As he makes clear in the preface:

> [T]he following inquiry into the nature, causes, utility, and further drift of business enterprise differs from other discussions of the same general range of facts. . . The point of view is that given by the business man's work, – the aims, motives, and means that condition current business traffic. This choice of a point of view is itself given by the current economic situation, in that the situation plainly is primarily a business situation. (Veblen, 1904/1975, p. I)

Beginning with presupposition is of course not arbitrary; it stems from Veblen's realization of institutional lag. What *is,* lags behind productive conditions, frustrating the circumstances necessary to bring human existence more fully in accord with its fundamental nature. Requisite to identifying the discrepancy between institutions and

[13] Sherman and Dugger discuss the misappropriation of the theory of evolution as a "conservative weapon," and propose that the gap between Marxist and Veblenian viewpoints can be bridged with useful discourse, on condition that evolutionary theory is rescued from misuse.

material production is, therefore, a discernment of those features that are peculiar to the system. The "business man," as a principal expression of modern existence, plants Veblen's inquiry solidly in the historically specific features of the present economic system, as does the commonplace commodity for Marx. As Veblen says, "In so far as the theorist aims to explain the specifically modern economic phenomena, his line of approach must be from the business man's standpoint, since it is from that standpoint that the course of these phenomena is directed" (Veblen 1904/1975, p. 4).

Moreover, as Marx begins with real premises and does not "abandon them for a moment," Veblen maintains this perspective throughout in order to arrive at an understanding of the way in which the system functions, and concurrently fails to produce the conditions most favorable to essential human life. Through this basic framework, Veblen broadly avoids the mystification of universalizing the particular that results in an apologia for the status quo. By means of this process, Veblen uncovers a system replete with conflict. As is too well known to require an exhaustive summary, in examining the shift in the method of business from the "handicraft era" to the "machine age" Veblen hits upon a fundamental contradiction in the modern organization of economic life.[14] That is, business enterprise, or pecuniary life, thrives on means inimical to machine industry, or material production. This prevents the complex of machine industry from realizing its potential (a potential it is autonomously propelled toward in accord with its own logic) so that the scheme of production in modern life, although sound from the viewpoint of modern business, is "inverted" from the logic of production in *general*. This antagonistic relation circumscribes the existence of business enterprise;

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[14] A concise summary of *The Theory of Business Enterprise* in the context of Veblen's research project may be found in Sweezy (1958, pp.182-188).

to prevail over or succumb to the machine process proves ephemeral. Should pecuniary life succeed in arresting material production in its pursuit of profit it effectively annihilates its material base. If it submits to the logic of industry, it simultaneously destroys its "spiritual" base – private property. Thus, business enterprise, by virtue of its principality in the organization of machine production, will ultimately hasten its own end. As Veblen explains, "[T]he full dominion of business enterprise is necessarily a transitory dominion. It stands to lose in the end whether the one or the other of the two divergent cultural tendencies wins, because it is incompatible with the ascendency of either" (Veblen, 1904/ 1975, p. 400). To be sure, for Veblen human history is a "blind drift," but it is not arbitrary; each historical stage grows out of the previous system in a process of cumulative causal sequence, so that as in Marx's system, the material and institutional conditions of present are the basic material for that which will replace it.[15] Considering the weight that has been given to the charge that Marx's system is "closed" it is worth noting once again that this conclusion to *The Theory of Business Enterprise* no more implies determinism in Veblen than a determinant mode of production following capitalism does in Marx. For Veblen the decline of business enterprise is "a question not of what ought to be done, but of what is to take place" (1904/1975, p. 377). This simply suggests that business enterprise will be supplanted by another organizing principle of economic life.

Also emerging from Veblen's analysis is a view of human social life as an object

[15] For example, mechanical standardization influences the point of view and consciousness of workers away from individual ownership. But beyond this, "It also furnishes the new terms in which the revised scheme of economic life takes form" as it creates the conditions in which trade unions are formed (Veblen, 1904/1975, p. 335).

of history, which, in line with Marx's system, does not deny its inherent subjectivity. It is to be remarked that for neither Veblen nor Marx does purposeful human activity imply a historical *telos*.[16] When Veblen identifies the worker as a "factor" in the mechanical process he is not suggesting a process in which human life is passively impressed upon by objective forces. Rather, human labor is *contained* within the machine process and

> It is by virtue of his necessarily taking an intelligent part in what is going forward that the mechanical process has its chief effect upon him. . . .His place is to take thought of the machine and its work in terms given him by the process that is going forward (Veblen, 1904/ 1975, pp. 307-308).

Humans create within inherited conditions, and the reciprocal relation between labor and the labor process creates a revolutionary potential in the modern age. That is, the recognition that private property is the source of productive inefficiency by those employed in industry admits a radical element into Veblen's system.[17] Here Veblen's view of labor as both subject and object of history is not only complementary to Marx's own ideas on the nature of labor, but as Hunt observes, adds an important dimension to Marxism with his thoroughgoing account of imperialism, nationalism, and emulative consumption as factors that absorb this would-be radical aspect of society (Hunt, 1979).

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[16] As Stanfield points out, common to both Veblen and Marx "teleological activity" (purposeful interaction with material life) is basic to human nature and the progression of human life. He contends that "the conscious teleological character of Veblen's instinct of workmanship," and instinctive action in general, of which Veblen himself considers teleological because "it involves holding to a purpose," is no different from purposive human action as a part of human nature in Marx (Stanfield, 1989, p. 98).

[17] As expressed in his (2006) explicit commentary on Marx's system, Veblen does not object to the inclusion of class struggle as a motive force in history, but instead to the primacy Marx assigns to it. (See Ford & McColloch, 2012, p. 768.) In *The Theory of Business Enterprise,* Veblen admits agreement with Marxist socialists concerning both the inability of the pecuniary classes to adopt a socialistic way of thinking and the radical potentiality in society as "proletarian" in substance. He does, however, wish to distinguish himself on the basis of what constitutes class, which he

As a final point, for both Veblen and Marx, as is well known, the modern system of ownership lies at the heart of today's power relations and is *the* institution humanity must eradicate in order to move beyond the existing mode of production and the alienation intrinsic to it. The foregoing analysis makes apparent the basis for such uniformity in conclusion. Essential to the picture of economic life that emerges from *The Theory of Business Enterprise* is the contradiction between the deepened social nature of production and private property. For Marx, capitalism, in contrast to previous modes of production, achieves objective human interdependence in production, a feature of modern life that is at once concealed by the asociality of property relations fundamental to this mode of production.[18] The intensified interdependence of production in the "modern industrial system" is also fundamental for Veblen's theory.

To be sure, when Veblen speaks of the "machine age" he is referring to the complex of industry as a *single* mechanical process, a scheme of production that grew up with the Natural Rights view of ownership and was solidified into an enforced system of

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sees as "a question not of relative wealth, but of work" (Veblen, 1904/ 1975, p. 348). Sweezy (1958) argues that while Veblen's notion of class comes "closer" to that of Marx in his later 1923 work *Absentee Ownership,* the Veblenian and Marxian notions of class are easily reconciled in as much as occupational discipline and class interest are mutually reinforcing. Even though this is not in disagreement with the viewpoint of the present paper, it is also worth noting, as pointed out by Ford and McColloch (2012), Marx's own ambiguity pertaining to the definition of social class. They point out in an endnote that this is particularly evident in Chapter 52 of *Capital* Vol. 3. As they put it, "For Marx, to conceive of class merely as a relation to ownership would be to treat class as an 'abstract universal' in Hegelese. It is only in the subjective moment, that is, through class struggle itself, that classes become manifest as 'concrete universals'" (2012, p. 12).

[18] For systematic discussion of Marx's concept of human nature as it underpins the nature of social evolution, see Hunt (1982) "Marx's concept of Human Nature and the Labor Theory of Value," pp. 2-25.

private property. As a result, the "spiritual" foundation of modern economic life tends to obscure the growing discrepancy between the sociality of production and antisocial nature of property relations. Given the efficiency inherent to both the instinct of workmanship[19] and the machine process, a system capable of providing for the material needs and wants of humanity is a potentiality yet unrealized. Hence, the priority Veblen and Marx as essentialists assign to the interrelatedness of modern production (itself made visible by way of chosen presupposition through which to navigate the specific nature of economic life) brings to light the "hidden" nature of ownership. Both conclude that on condition the present system of ownership persists, human beings are blocked from living in a system more fully in accord with their essential nature.

Concluding Remarks

For Marx, inquiry should begin devoid of appearances no more than it should begin and end with them, as the result – even if unintentionally – tends to justify existing conditions. This is central to his critique of classical political economy. Veblen similarly critiques what he termed "neo-classical" economics for universalizing aspects unique to capitalism, as, for example, the universalization of private property that legitimizes existent class relations just discussed. In taking a similar approach, Veblen arrives at an understanding of capitalism in accordance with, and complementary to, that of Marx. It is contended that Veblen's chosen starting point – the modern "business man" – in *The*

[19] The stifling of this essential human instinct, as when labor becomes "irksome," places society in a persisted state of "arrested spiritual development" (Veblen, 1994, p. 254)

Theory of Business Enterprise reveals a great deal about his essential methodology, as does Marx's choice to begin *Capital* with the simple commodity form. In both cases, we are able to appreciate the inverted reality in which we live and its theoretical apologias, only by first adopting such a mediated perspective. It is this rendering of the inverted nature of economic life that seems to attract ongoing comparisons of Marx and Veblen in the literature of political economy and history of thought, and it is hoped that the parallel in method here drawn can contribute to this debate.

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THE VEBLENIAN ROOTS OF INSTITUTIONAL POLITICAL ECONOMY[1]

Abstract

The term "Institutional Economics" has been applied to some of capitalism's strongest critics as well as its most ardent apologists. This paradox in terms has bred contradictory literature in development economics, some declaring the death of this line of thought whereas others herald its resurgence. In examining the roots of Institutional economics, this essay attempts to disentangle the ambiguity surrounding this label. The Institutional Political Economy of Ha-Joon Chang will then be examined as a return to Institutionalism's radical roots in development economics. Concluding remarks suggest that this approach is capable of encompassing gender as an analytical category, an extension that would improve the ability of policy makers to assess the impacts of macroeconomic policy.

Introduction

A quick glance at development literature can leave the reader with no thought other than "institutions matter." However, such a thought should not be taken for granted. What once was precluded from economic lines of inquiry as a consequence of the stale,

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lifeless notion of isolated economic man, has traversed the distance from Classical Political Economy, to the center of policy making with the likes of J. R. Commons and others, relegated to the underbelly of heterodoxy, and more recently, has basked in the limelight of mainstream economics. Indeed, Philip A. Klein pronounced that in spite of Paul Samuelson's declaration of the death of Institutionalism, "in the field of development Economics the victory has been so complete that many economists fail to realize it or to credit Institutionalists with contributing any part of the current analytical framework of development economics" (Klein, 1977, p. 785).

However, a review of Institutional literature reveals a remarkable difference in the way in which institutions are viewed, the function of private property, and policy implications that result. This is the result of a bifurcation in Institutionalism, resulting in the categories of Old Institutional Economics (OIE) and New Institutional Economics (NIE). This essay examines what distinguishes "old" from "new," concluding that only the former is capable of challenging existing power relations at all levels of inequality. The remainder of this essay is divided into four sections. The first surveys Veblen's Institutionalism, the basis of OIE. The next section considers the work of Douglass North and Oliver Williamson, the originators of NIE. Having established distinguishing features of OIE and NIE, Ha-Joon Chang's Institutional Political Economy is explored as a return to Veblenian Institutionalism in development economics. Concluding remarks follow.

The Economics of Thorstein Veblen

Veblen's Institutionalism is rooted within a Darwinian framework; hence he considered himself pioneering an "Evolutionary Economics" (Veblen, 1898a). Such an endeavor was in direct response to Marginal Utility Theory, or, in his chosen vernacular, "hedonist" economics. Therefore, in order to understand what Veblen wished to construct, it is useful to first understand what he meant to tear down.

Veblen brandished the term "neo-classical" ostentatiously at marginalist economics – what he considered to be the maladroit child of the "classical" economics of the 19th century. While he dismisses both lines of economics as teleological and inconsistent in moving from cause to effect within their own theoretical underpinnings, he is more critical of the neoclassical school, which "is confined within narrower limits and sticks more consistently to its teleological premises" (Veblen, 1909, p. 621). As is typical of Veblenian sardonicism, his insult swung too high, and marginalist economists embraced and adopted the term (Chavance, 2008).

His critique was complete, arguing that it is ahistorical, "of a wholly statical character," and unable to comprehend the world in which it exists (Veblen, 1919,p. 232). This, he argues, is a necessary outcome of an analysis that takes what *is*, as *given*. Such a starting point renders neoclassical economics nonscientific, shutting off lines of inquiry where they should begin. Limited to the narrow range in which values adjust to a given situation, it is incapable of grasping origin or human historical movement, perceiving only constraints posed by the bounded economic circumstance so assumed. A theory of price emerges, but "as to the causes of change or the unfolding sequence of the phenomena of economic life they have had nothing to say hitherto; nor can they, since their theory is not drawn in causal terms but in terms of teleology" (Veblen, 1909, p. 621).

In proceeding from a reductionist methodology, neoclassical economics is at oncethwarted from analyzing the foundation of habitual action from the perspective of the system as a whole, precluding true understanding of sensuous human activity. "Hedonistic man" moves through space and time without pulse or consciousness. He is:

> a lightning calculator of pleasures and pains, who oscillates like a homogenous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. . . He is an isolated, definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. . . When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before. (Veblen 1919, p. 73)

Thus, humans are not a living process. They are but matter, with exogenously given preferences and void of the human relations of which the social fabric is spun. Institutions are "taken for granted, denied, or explained away" (Veblen,1909, p. 622). Such an abstraction yields a theory lacking correspondence to reality, defeating the purpose of theoretical modeling. From this perspective, Ludwig Feuerbach's critique of the "speculative" Hegelian philosophers who "pluck out their eyes that they may see better" may just as well have been written by Veblen in view of Utilitarianism (Feuerbach, 1989). In economic theory, the stakes of such abstraction are high, above all when a school enjoys the status of the dominant paradigm and so persuades policy.

For Veblen, human and economic development can only be understood in terms of growth and change; therefore a true understanding of economic phenomena requires that nothing be taken as given (Veblen, 1898). What *is*, is not eternal, existent from time immemorial. The web of relations, material conditions, and institutional structure within which we carry on the life process has origin, sculpted in time and culture, constituting its present form. Questions of the life history of human activity are questions of cultural growth, which for Veblen, in true Darwinian fashion, is a process of nonteleological cumulative causal sequence.

From this perspective, an inquiry into institutions and their role in cultural growth is central. For Veblen, institutions are the customs and "settled habits of thought common to the generality of man" (Veblen, 1919, p. 239) As such, these evolutionary elements are rooted in culture and explain the historical movement of social structures. These social norms and customs become solidified into institutions, which in turn come back and shape our customs and habits of thought. In stark contrast to hedonistic man with exogenously given preferences, these customs and habits of thought are changing endogenously over time. This complex causal relation between individuals and institutions underlies Veblen's notion of cumulative causation, which emphasizes sequential change and the cumulative nature of these changes, a "theory of a process of cultural growth as determined by the economic interest… of a cumulative sequence of economic institutions stated in terms of the process itself" (Veblen, 1898, p. 398).

Following Bernard Chavance, Veblenian causation can be understood as a type of "recursive causation" (Chavance, 2008). Whereas a "linear" notion of causation follows cause to effect and considers its work complete, recursive causation continues, bringing to light the influence effect has on cause. Veblen tells us that human life "is a struggle for existence, and therefore it is a process of selective adaptation. The evolution of social structure has been a process of natural selection of institutions" (Veblen, 1994, p. 188). In understanding his complex causality we can see that institutions are both object *and* factors of selection in this process of selection.

> Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection. (1994, p. 188)

Thus, preferences become "endogenized" in this evolutionary process (Chavance, 2008).

Once this cumulative causation is understood, it becomes clear that Veblen's rejection of methodological individualism in no way implies that the study of human beings is outside the scope of understanding economic phenomena. Indeed, it is variation in cultural customs and habit that gives motion and change to social structures.

> Changes in the material facts breed further change only through the human factor. It is in the human material that the continuity of development is to be looked for; and it is here, therefore, that the motor forces of the process of economic development must be studied if they are to be studied in action at all. (Veblen, 1898, p. 388)

Once this is understood we can see that Veblen was neither purely holistic, nor purely reductionist, but moved between the social whole and the individual with methodological consistency (Hodgeson, 2004).

In order to fully understand Veblen's approach to economics and growth, it is important to grasp his theory of human nature, which he emphatically rejected as static. The way in which Veblen accounts for human *active* nature is in his theory of instincts (Hessian & Sardy, 1969). According to Veblen, humans have certain innate instincts that embody both potential and propensities. These instincts are genetically and culturally inherited and conditioned, and are more or less manifest depending on the particular historical and material conditions individuals reside in, which is to say, human nature adapts to the demands of the situation.

These instincts fall into two general categories: those that are advantageous to the social whole and those that are injurious. Among the former are the instincts of parental bent, idle curiosity, and workmanship. The latter set of instincts includes predatory behavior, arrogance, and emulation. One of the main drivers behind human behavior is status, and the instinct of arrogance compels individuals to put this into evidence by making invidious distinctions. However, that which bestows status, and the form that invidious distinction takes, is dependent on historical circumstance. For example, in primitive communal societies the instinct of workmanship (a taste for effective work and distaste for "futile effort") was a point for invidious distinction. An individual demonstrated efficiency by doing work that promoted survival of the group. With the dawning of economic surplus cultures became warlike societies, bringing the predatory instinct into dominance. Aggression, seizure, and plunder became the "accredited form of action," and a conspicuous display of ill-gotten gains became the way to put status into evidence. As a result, an invidious distinction between exploit and industrial employment was created, and engagement in industrious behavior became socially inferior and "irksome" (Veblen, 1994).

For Veblen, economic growth in capitalism is threatened by the dominance of the predatory instinct, as it breeds inefficiency and waste. His notion of growth rests in his evolutionary system and cumulative causation. Therefore, his concern was not with short-run fluctuations in output, but rather one of long-run structural change and the *composition* of output. Thus, increased output is not a sufficient condition for economic development. For sustained growth to occur, output must be of the type that smoothes the progress of technological advancement (Hessian & Sardy, 1969). The composition of output is critical for Veblen because in the very process of growth, the institutional fabric of the economy is transformed. Technology is itself an institution, as both object and factor of selection, shaping capitalist institutions and the social mind-set. As Veblen explains:

> The mechanical equipment and the standardized processes in which the mechanical equipment is engaged. . . embodies not the manual skill, dexterity, and judgment of an individual workman but rather the accumulated technological wisdom of the community. (In Gruchy, 1958, p. 161)

From this view, technological progress has an evolutionary function, challenging existing institutions and the power relations embedded in them.

However, Veblen did not maintain that the mere appearance of some new technology would directly bring about the new institutions that would allow for the full effect of technological progress. He recognized an institutional stubbornness, making economic growth a strained and often broken process. The difficulty lies in what he termed institutional lag. This is the observation that there is ever a gap between today's institutions and the current needs of society. "Institutions are products of the past process, are adapted to past circumstances, and are therefore never in full accord with the requirements of the present" (Veblen, 1994, p. 191). Given that each step in institutional evolution is shaped by what was before, cumulative causation necessarily entails institutional inertia. This is exacerbated by an inherently antievolutionary element that tenaciously resists progressive tendencies. Social inertia, or "past-bound drag of cultural habit wedded to privilege," is solidified in the present in what Veblen called "imbecile institutions" (Jennings & Waller, 1994, p. 110). Those in power are capable of impeding new social interpretations that would allow society to address the needs of today, and their imbecile institutions rationalize their power position, spilling over into the attitudes of those lower in the social strata. Veblen recognized that neoclassical economics in all ways fits this bill, hence his scathing critique of its method.

> They are principles of action which underlie the current, business-like scheme of economic life, and as such, as practical grounds of conduct, they are not to be called in question without questioning the existing law and order. (Veblen, 1909, p. 626)

In other words, the neoclassical paradigm functions as an apologia for the existing state of affairs. To question its validity is to question nothing short of the whole of society, and the power relations therein.

Veblen illustrates the way this power elite acts as an antievolutionary element to social progress in his *Theory of the Leisure Class*, which demonstrates the role and extent to which the leisure class, a refined version of yesterday's predatory class, affects the social structure. Put simply, there occurs a "selective elimination" of individuals who dare challenge the status quo. That is not to say that those who recognize institutional lag and the "imbecile institutions" that perpetuate unhappy social relations are entirely eliminated – this would remove the variation required for an evolutionary system. It does, however, highlight a significant source of rigidity in terms of institutional adaptation.

When the invidious distinction of a society is attached to nonindustrious occupations, as is the case in capitalist enterprise where the predatory instinct dominates "captains of industry," economic growth is threatened. The upper tier of the social strata gain prestige by putting their lack of engagement in productive work on conspicuous display, engaging in conspicuous consumption (a conspicuous waste of goods) and conspicuous leisure (a conspicuous waste of time). This lifestyle establishes a standard of living for all of society, changing general habits of thought and disseminating an ideology of inefficiency and waste throughout the culture. In this regard Veblen astutely recognized the antirevolutionary nature of society *in general*. From this perspective the lower social strata, engaged in productive efforts, not only face obstacles to bringing about social change with the barrier of imbecile institutions, they simply do not wish to revolt against those who hold the power. Rather, they aim to become one of them. Should this effort fail, which it most certainly will, they will at least attempt to look and act like them through pecuniary emulation of conspicuous waste and leisure.

Returning to his notion of economic growth, Veblen saw the *potential* in new technology to eventually corrode imbecile institutions and restructure society in conformity to its needs. This is a potential because Veblen saw no reason that it had to unfold this way. As a result of complex and cumulative causality, Veblen saw human history evolving in a "blind drift," or in the manner of path dependence (Jennings & Walker, 1994). That part of the population that is immediately in contact with the technological process would have the instinct of workmanship more strongly expressed in their nature, and consequently would develop a matter-of-fact way of viewing their world. This class would necessarily recognize the inefficiency of the captains of industry, and would ultimately take over the productive process to ensure efficiency in production (Veblen, 1914/1990). Veblen did not conceive of this as a swift or seamless process, and lamented the considerable waste that society would incur in this evolutionary unfolding. He saw only two paths the United States could pass over: a road to socialism, or a road to complete fascism (Gruchy, 1958). This latter road would be the consequence of assiduous exploitation of the working masses by the vested interests.

Those who followed the Veblenian tradition, termed OIE, carried on many of his themes: placing institutions at the center of analysis, recognizing the role of technology in growth and the nonautomatic nature of its dissemination, and the centrality of cumulative causation in economic development. However, from this they extracted an optimism rather than pessimism. For these Institutionalists a third road appeared on the horizon, one in which the human element in the recursive causation between individuals and institutions plays an active role in eroding imbecile institutions. Economists such as Clarence Ayres, J.R. Commons, and Wesley Mitchell saw the Veblenian insight as one in which policy could be the tool to fashion capitalist institutions in a way that would promote efficiency and limit its tendency to reproduce and deepen economic inequality.

As Paul M. Sweezy points out, “Veblen treated the United States as the prototype of an advanced capitalist society, just as Marx, writing earlier, had assigned that role to Great Britain”(1958, p. 177). He may well have said this of Veblen’s earliest disciples, who “used the U.S. economy almost exclusively as their geographic unit of analysis” (Peach, 2003, p. 128). However, over time Institutionalism did begin to gain a global perspective as economists such as John Kenneth Galbraith and Wendell Gordon began to apply the institutional paradigm to their studies of development and international economics, and economists outside the U.S., notably Nobel Laureate Gunnar Myrdal, also made use of the institutional framework to discuss international economic issues (Peach, 2003). From being in the center of U.S. economic policy in the early part of the 20th century, to marginally existing on the fringes of heterodox economics by the latter half, this “Old Institutionalism” has nonetheless survived to inform modern economists who are attuned to its basic tenets. As will be discussed below, it has made a particularly useful reemergence in the field of development economics.

As will be argued below, not all Institutional economics are created equal. By the mid-1970s a development in economic thought bearing the name "Institutional" emerged from a paradoxical source: Veblen's so-called "neo-classical" economics. Appropriately, it was a qualified Institutionalism, lest it be dismissed as a return to a radical Veblenian school, and thus New Institutional Economics, or NIE, was born.

New Institutional Economics

The names Douglass North and Oliver Williamson have become synonymous with this branch of economics. Broadly speaking, the assumptions underlying this deductive school of thought are the existence of certain institutions because they have the lowest transaction costs, and the notion that institutions should be envisaged as the interactions of individuals from which institutions emerge. Although at times there may be some recognition of endogenized preferences through the influence of institutions, this typically enters in ad hoc and fails to be fully wed to theory. For methodological legitimacy to be maintained, analysis begins with Homo economicus, justifiable as an "Ideal Type" in the vein of Max Weber. According to Malcolm Rutherford, the fundamental distinction in outlook "shows up in the tendency of new Institutionalists to see the development and functioning of institutions largely in efficiency and economizing terms. . . as opposed to the old Institutionalist who tends to see many other social and political factors (status, group identity, ideology, and economic and political power) as also involved" (Rutherford, 1995, p. 444).

For Williamson, emphasis is placed on transaction costs, adapted from Coase'stheory of the firm. This necessarily entails a study of individual action and rationality. As will be seen with North as well, one of the first tasks Williamson sets for himself is a reevaluation of the notion of strict rationality of methodological individualism. This is achieved with a "bounded rationality," such that the individual agent, in pursuit of self- interest, is limited by the inability to perfectly predict the risks and uncertainties implicit in contract agreements. In Williamson's own words, this rationality "refers to rate and storage limits on the capacities of the individuals to receive, store, retrieve and process information without error" (1973, p. 317) In contrast to Simon Herbert's bounded rationality, which results in satisficing behavior in the individual, Williamson's usage of this concept is terminal in transaction costs. Additionally, the individual is thoroughly infused with "opportunism," which is "an effort to realize individual gains through a lack of candor or honesty in transactions" (Williamson, 1973, p. 317). Though coercion is not within the economic agent's given motivation set, the individual is "farsighted" in terms of outcomes and will conceal or bend information to the other party in pursuit of the best possible outcome, thus yielding high costs in transaction.

The institution of interest to Williamson (1998) is the "governance structure," which is where transactions and negotiations occur. When specific investments must be made by either buyer or seller in a transaction, a problem of "asset specificity" arises. It becomes more cost efficient for these two parties to merge than remain separate and incur rising transaction costs. This "mutual dependence" therefore occasions the need for a governance structure capable of organizing their activities. Changes in these structures change the comparative costs, such that the “institutional environment is a ‘shift parameter’ – a datum for the actors” (Groenwegen, Kerstholt, & Nagelkerke, 1995, p. 470). Although Williamson recognizes agents as they may try to influence legal institutions, this is not decisive to his analysis. In the end, this leads him to praise the “institutional reforms” of the Washington Consensus, which place private property and contract enforcement at the heart of the policy agenda, as pointed out by Herrera (2006).

Similar to Williamson, Douglass North wishes not to replace neoclassical theory, but rather to “build on, modify, and extend” it in order to incorporate a theory of institutions into economics (North, 1993). He maintains the assumptions underpinning microeconomics of competition for scarce resources, and therefore sees the study of economics as a theory of choice subject to constraints. For North, institutions should be central to any economic theory as they are the critical constraints individual agents face in achieving their objectives. Drawing upon Coase, he sees institutions formed by economic agents in order to decrease uncertainty in exchange, and he emphasizes the connection between neoclassical theory, institutions, and transaction costs:

> The neoclassical result of efficient markets only obtains when it is costless to transact. When it is costly to transact, institutions matter. And because a large part of our national income is devoted to transacting, institutions and specifically property rights are crucial determinants of the efficiency of markets. [Coase’s] insight is the key to unraveling the tangled skein of the performance of economics over time, which is my primary concern. (North, 1993, p. 2)

What we see from this statement is that the assumptions underlying neoclassical economics are not incorrect per se, but rather that we live in a world of asymmetric information and therefore market imperfections. If this could somehow be rectified, institutions would cease to be of economic relevance. This stands in stark contrast to a Veblenian understanding of the nature of institutions. As fundamentally social beings who must organize in order that production takes place, institutions are the very substance of human life. Thus, from a Veblenian perspective the phrase "institutions matter" goes without saying, and necessitates no qualification (Veblen, 1898a).

However, working from a framework that places individuals as the proper starting point for analysis, North accomplishes his task of incorporating institutions into the neoclassical paradigm by modifying "instrumental rationality," as this is the element he pinpoints as the source that causes institutions to vanish from neoclassical analysis. Under its strict assumptions, individuals operating on the basis of instrumental rationality necessarily act on the basis of optimization, with the choice of ends as given. In such a scenario there is no need to discuss the role of institutions; they simply do not enter analysis. As has already been established, however, in our lamentably imperfect world (lamentable on the grounds that we have not achieved perfect competition), "institutions matter." North looks for his modification to the strict rationality of methodological individualism in the way in which human beings process information.

According to cognitive science, humans possess mental modes that allow them to understand their world. These are bestowed upon us through culture, which articulates values, norms, and custom, as well as through our experiences within our "local" environment. In this way variation in mental modes and world perception can be accounted for. Individual action stems from these mental modes, and can be altered if presented with an experience that contradicts what would have been expected on the basis of these modes. This results in "multiple equilibria." As a result, world perceptions are limited and vary widely from one individual to the next, creating an environment riddled with asymmetrically held information and an inability to process all the necessary information required for transparent and harmonious exchange. Returning once again to Coase, information bears a high price in this environment, and it is this in combination with contract enforcement costs that the costs of transaction are determined. The upshot of this line of reasoning is that institutions, in order to reduce the uncertainty inherent in exchange, are born of transaction costs.

What has emerged is a linear causality: from individuals to institutions. Not surprisingly then, North has a different conception of institutions. They are, "the rules of the game of a society, or more formally, the humanly-devised constraints that structure human interaction," which entail both formal, and informal institutions, as well as the "enforcement characteristics of both" (1993, p. 5). These he distinguishes from organizations, which are the "players," grouped together by function and purpose. For example, firms, labor unions, churches, and political parties all fall under organizations. Institutional change, or "modification," then takes place based upon individual maximizing behavior. If individuals believe they can improve their outcomes by reorganizing the terms of exchange, they will do so, and incremental, path dependent institutional change transpires. In a notion that reminisces of Veblen's imbecile institutions, North argues that the individuals and organizations with bargaining power in a society are also the agents that have a stake in maintaining the system. The consequence he sees to this is that an economy on an "inefficient" path will persist on this as a result of the institutional inertia the privileged are able to sustain.

For North, the primary driver of institutional change and economic growth is not the engineer that Veblen saw such revolutionary potential in, but the entrepreneur within an organization. Entrepreneurial "learning" dictates both the rate and direction of economic change. While North does grant Veblen an element of "idle curiosity," he does not factor it into his motivations for invention and innovation. His purpose is to give an "institutional/cognitive story" of economic change in the long run. The true source is to be found in the neoclassical assumptions that stand at the base of the New Institutional Economics. The more competitive is a market, the higher the rate of learning and the faster will economic change occur. The type of learning that takes place governs the direction in which economic change moves, and is a reflection of the mental modes of the individuals involved and the incentive structure as determined by the institutional framework. The primary incentive structure is, of course, strong property rights. What North gives us then is a radically conventional story of the entrepreneurial spirit motivated by pecuniary gain, nurtured and made stronger with the institution of private property.

North, as promised, brings his thesis to the State, as the institution that enforces the so-called "rules of the game." This, he argues, is an improvement upon neoclassical economics, which typically views the State as exogenous or irrelevant to economic development. Here the emphasis is on "getting prices right" by removing State action that would inhibit the natural movement of prices toward equilibrium. Adhering to the principle of perfect competition in theory, North argues that this holds true only if property rights are such that the conditions for competitive markets are created and sustained. "It is polities that shape economic performance because they define and enforce the economic rules of the game. Therefore the heart of development policy must be the creation of polities that will create and enforce efficient property rights" (1993,

p. 7). In this way he has brought institutions into light not just as constraints, but also as entities that can enable economic agents, specifically, by improving efficiency.

Although North has indeed brought institutions to the center of analysis, NIE is still theoretically bound to a notion that holds the competitive marketplace as the natural ordering of economic life. The State has a place insofar as it supports the objective of maintaining it where it is existent, and cultivating this environment where it is deficient. As Malcolm Rutherford again points out,

> Despite his references to the limited computational power of individuals, to cognitive psychology, and to the influence of social norms – all of which lead us to rule-guided behavior, North persists in describing the activities of individuals and entrepreneurs predominantly in terms of self- interested maximization. (Rutherford, 1995, p. 447)

Groenwegen et al. conclude similarly, “the [NIE] is of an individualistic, deductive nature. After having characterized the transaction, different potential governance structures are discussed in terms of their transaction cost minimization. Then hypotheses are confirmed using historical examples” (1995, p. 471). While North makes mention of the Veblenian elements of power, ideology, and myth, they are not effectively integrated into his theoretical assumptions, and therefore fail to play a decisive role in the policy prescription that follows. When causality runs from the self-interested individual to institutions, and institutions are deemed the “rules of the game,” institutional policy is one of either constraining or channeling individual behavior in a way that yields optimum efficiency.

The appeal of such reasoning is not difficult to see. What has emerged is a straightforward guide to economic development that tends to justify the existing state of affairs in capitalist developed countries, and is backed with all the legitimacy of the dominant paradigm in economics. Indeed, the World Bank adopted the philosophical underpinnings of this NIE by the early 1990s, as the phrase "institutions matter" became increasingly ubiquitous. A quick survey of this literature reveals institutions as "rules of the game," with emphasis placed on contract agreements and strong property rights. (See for example Javed & Perry, 1998, and Poverty Reduction and Economic Management Network, 2000.) Establishment of robust property rights, alongside other "good" institutions that would foster "good governance," became the strategy for promoting economic growth worldwide.

It is in this context that Ha-Joon Chang can be understood, as he offers up a direct response to this development in the Washington Consensus. His critiques of this policy and the methodological foundations that guide it bear striking resemblance to Veblen's critique of neoclassical economics. This is of no accident, given that NIE is firmly rooted in neoclassical economics and Chang is a methodological return to OIE. Taking a historical approach to the study of economics, critiquing the dominant paradigm for taking what *is*, specifically institutions, *as given*, recognizing institutional lag and the recursive nature of causation, Chang brings Veblenian insight to the field of development economics.

Ha-Joon Chang's Institutonal Political Economy

One of the fundamental critiques Chang has of the "so-called New Institutional Economics" is that an emphasis on institutions is not enough, and he finds fault in its failure to break from neoclassical economics in an authentic and essential way (Chang, 2003b). Insofar as NIE views institutions as constraints that can generate inefficiencies, as a school of economic thought it is entirely consistent with the mainstream economics, and demonstrates a linear causality. Where it adds dimension to the orthodox conception of institutions is in the recognition that institutions can also play an "enabling" function. However, as was seen in North, "they still maintain the myth that the unconstrained market is the natural order, while institutions are man-made substitutes that should be (and will be) deployed only when that natural order breaks down" (Chang & Evans 2005, p. 102). Bringing institutions to light, Chang argues, is a necessary, but not a sufficient condition in understanding the nature of economic development. Institutions *do* matter, but the way in which they are understood is of grave importance. As Chang points out, even good intentions, if misinformed, can mean utter devastation to a nation. Institutions deemed "good" and "natural" in capitalist developed countries are transplanted onto developing capitalist countries, often with great consequence. Thus the definition and understanding of institutions is far more than an exercise in semantics, "people are hurt because social scientists and policy makers misunderstand institutions" (Chang & Evans, 2005, p. 100).

To remedy this misconception of the nature of development in general, and institutions in particular, Chang develops a theoretical framework of Institutional Political economy, or IPE. (Chang, 2003a) From this perspective institutions are defined as "systematic patterns of shared expectations, taken-for-granted assumptions, accepted norms and routines of interaction that have robust effects on shaping the motivations and behavior sets of interconnected social actors" (Chang & Evans, 2005, p. 99). Thus, institutions are not axiomatically taken as the maxims of a game, but run much deeper, indeed into Veblen's customs and habits of thought, highlighting human nature as one of social being. From this vantage point, a view of human life as it interacts with institutions recursively once again emerges.

Chang refers to this interaction as the "constitutive" nature of institutions, which highlights an endogenous process of preference formation. In starting at the cognitive level before theoretically erecting institutions built of individual maximizing rituals, NEI maintains exogenous preferences and thus fails to recognize the profound nature of their basic unit of analysis. For Chang, institutions are such a part of the social fabric that they transform the very substance that motivates us. IPE, then, does not take human motivations as given,

> But as being fundamentally shaped by the institutions surrounding the individuals. This is because institutions embody certain 'values' and, by operating under these institutions, individuals inevitably internalize some of these values, thereby altering themselves. This [constitutive role of institutions] is a central hallmark of a truly 'Institutionalist' approach. (Chang 2007, pp. 54-55)

There are three "mechanisms" by which this constitutive aspect operates. First, institutions have the capacity to shape what human beings perceive to be in their interest. Second, they are of the nature that they can imbue the common view of *which* issues are valid for political action, and, finally, institutions shape what is perceived to be the legitimate *forms* of such political action (Chang, 2002). Institutions are constraints, to be sure, while also having the capacity to enable in the sense that North discussed above, but must also be understood as one element of a two-way street of causation. From the perspective of NIE it is a narrow one-way path, with direction running from individual (cause) to institution (effect.) Although more "sophisticated" approaches have emerged from the simple dimensions of NIE, Chang and Evans (2005) argue that the challenge of developing a strong theory of culture remains.

Much of Chang's historical analysis reveals a Veblenian institutional lag. Indeed, this is the main thrust of his book *Kicking Away the Ladder: Development Strategy in Historical Perspective.* Looking at institutions such as universal suffrage, central banking, protection of property rights, and child labor regulation in the now developed capitalist countries, or NDCs, he demonstrates temporal delay from when the need for these institutions surfaced and when they finally became institutionalized. For example, universal suffrage in the U.S. was not achieved until a full 95 years after the vote was given universally to men. Even this is misleading, however, as this universal male suffrage was reversed only 20 years later as African American males were disenfranchised, and did not witness their voting rights restored until 1965. In the case of Switzerland and France it took nearly 100 years (Chang 2007). Furthermore, a comparative look at GDP per capita reveals that the NDCs were much wealthier at the time they erected these "good" institutions than has perhaps been perceived. "In the early days of their economic development, the NDCs were operating with far less developed institutional structures than those which exist in today's developing countries that are at comparable levels of development" (Chang, 2003b, p. 515). Even once these institutions were erected in the NDCs it was not a seamless process. As shown above in the case of male suffrage in the U.S., reversals often took place. Thus, arguments that claim that "good governance" preceded and fostered growth are simply inaccurate. When put in historical perspective, precisely the reverse thesis emerges.

Although Chang makes clear that reasons for institutional lag vary country by country, there are broadly two explanations underpinning this gap. Put simply, institutions are expensive, and it was untenable to adopt social welfare programs when resources were lacking. There is also, however, an element of "social inertia" that takes place. Once again, a historical view reveals that the wealthy elite actively block progressive change. Although he does not use the term "imbecile institutions," Chang is capturing the essence of the way in which Veblen's privileged class was able to hinder social change. Child labor laws and voting rights were not in the interest of the upper tier, and through their control over institutions they were able to hinder such developments for decades in the U.S. However, Chang is not entirely pessimistic. The constitutive nature of institutions has the consequence that when an institution is put into place what once was unthinkable, such as banning child labor, over time changes human motivations. Child labor is now universally accepted as inappropriate and exploitative in the NDCs. Furthermore, this recognition of privilege wedded to power does not mean policy cannot be actively altered, it merely highlights the challenges that will be faced. As Chang and Ilene Grabel argue, "it is both fatalistic and incorrect to act as if their [IMF, World Bank, and WTO] power and influence are absolute and immutable" (Chang & Grabel, 2004, p. 203).

Chang also stresses the significance of institutional inheritance in the formation of new institutions, the result of which is institutional path dependency. From this view, new institutions are adaptations of old institutions, and are erected of the same material. "The strong element of legacy, inertia, and path dependence in the determination of institutional forms" must be recognized by those who would ask capitalist developing countries to implement a "global standard" of "good" institutions in as short a time span as 5 to 10 years (Chang & Evans, 2005, p. 104). Again, it must be remembered that it often took the NDCs generations to develop their current institutions. It must also be recognized that not all institutions packaged as "good governance" are necessary. The imposition of an unneeded institution may come at the cost of other, necessary institutions.

Having outlined Chang's approach to development economics, it is worth returning to what is perhaps the most fundamental critique waged at the NIE: the tendency to take institutions as given. For Veblen this was what rendered neoclassical economics ineffective, shutting off the "inquiry at the point where modern scientific interest sets in" (Veblen, 1919, p. 240). What Veblen was pointing to was the tendency to observe current institutions, generalize them, and then view all times and all places in history through this lens. With such an approach to history it is no surprise that verifications abound. This method presupposes that what is, must be right. The notion of institutional lag, however, would suggest just the opposite. As Veblen is quoted as saying, "What is, is wrong" (Lekachman, 1994, p. viii). Chang continually refutes ahistorical theory and policy that assumes, in essence, that regarding institutions in the NDCs – particularly the U.S. – what is, is right. "History is written by the victors, and it is human nature to reinterpret the past from the point of view of the present" (Chang, 2007, p. 64).

Among the most critical institutions to have been presumed "natural," with perhaps the greatest consequence, is that of private property. According to E.K. Hunt, one of the defining characteristics of OIE "has always been its concern with the organization and control of the economy. This has inevitably involved an analysis of the structure of power – a topic systematically avoided by the mainstream economists. For most Institutionalist economists an analysis of power necessarily involves a study of the complex institution of property. . ." (Hunt, 1994, p. 54) Indeed, one of Veblen's major tasks was to move beyond the "Natural Rights" view on the origin of private property to uncover the genesis of modern ownership (Veblen, 1898b).

For Veblen, ownership is a cultural fact that must be learned, not a fact of nature to be presupposed. According to the natural-rights theory, the "natural" owner of some object is the individual that either produced it, or somehow improved upon it. The basis of ownership in this view then is rooted in a self-sufficing individual, an individual Veblen denies has ever existed.

> Within the human period of the race development, it is safe to say, no individual has fallen into industrial isolation, so as to produce any one useful article by his own independent effort alone . . . .The only possible exceptions to this rule are those instances of lost or cast-off children nourished by wild beasts. . . But the anomalous, half-hypothetical life of these waifs can scarcely have affected social development to the extent of originating the institution of ownership. (Veblen, 1898a, pp. 33-34)

Not only is the self-sufficing individual a mythical creature, but a glimpse into our own history reveals that being engaged in the production of some article does not entitle one to that which they produce. As Veblen sagaciously observes, serfdom and slavery are clear demonstrations that "those who work cannot own, and those who own cannot work" (Veblen, 1898a, p. 42). He includes women's productive efforts in the patriarchal home as another example of this aphorism, ultimately rooting the "beginnings of ownership" to the seizure of women and the products of their labor once apprehended. Ownership of a "trophy wife" becomes the preferred way of putting one's physical prowess into evidence and demonstration of invidious distinction. Passed from one generation to the next, this becomes solidified into the institutions of ownershipmarriage and private property. NIE, in contrast, views the function of private property quite differently. From this perspective the modern form of ownership is not a conflictive element in society, but is the foundation upon which successful capitalist countries were built. Bestowed upon this institution is the power to unleash the entrepreneurial spirit, so it is not surprising that the origin of private property is rooted in special cultural characteristics. Although not the first to emphasize culture as the source of capitalist development, David Landes is representative of this line of thought. He argues that the origin of private property is to be found in medieval Europe, specifically, the Judaic-Christian tradition (Landes, 1999). Although not all New Institutionalists who argue that private property is the key to capitalist development see the genesis of modern ownership in culture, the story and policy converge with the conventional story once the institution of private property is historically reached. For example, authors such as Daron Acemoglu see existing wealth and labor exploitative opportunity of colonizers as the basis for this institutional development (Acemoglu, Johnson & Robinson, 2002). Sokoloff and Engerman (2000) place emphasis on geography and factor endowments as the route to private property. Once this stage is reached, entrepreneurial energy, from which economic growth and development springs, is allowed to flourish. As Landes says, "why should anyone invest capital or labor in the creation or acquisition of wealth that he may not be allowed to keep?" (1999, p. 32).

Chang points out that it is this myth of the sanctity of private property and the promotion of privatization through the Washington Consensus that is the cause for so much hardship in capitalist developing countries. The New Institutionalist neoliberal view sees patents, copyrights, and trademarks as critical in the development of the NDCs and argues that monetary incentives for invention and innovation are the only appropriate incentives. Although arguing that at times privatization is the appropriate policy, Chang and Grabel (2004) point out that this process is both expensive and complex. It results in a great burden on the State, even as the private sector profits. In terms of patents and copyrights, historical canvassing does not support the claim that economic growth follows from strict property rights. In fact, it supports just the opposite. Much growth in NDCs took place *before* patents and copyrights were existent, or when they were particularly weak (Chang, 2007; Chang, 2003a; Chang 2003b; Chang & Grabel, 2004). Furthermore, not all motivations underpinning invention and innovation are of a pecuniary nature. History, Chang points out, is full of examples of innovation driven by a motivation for the public good. Yet the Washington Consensus enforces strict intellectual property rights, privatization, and enforcement of private property in the name of economic growth. In looking at such policy as dictated by the NDCs via the WTO, World Bank, and the IMF on the developing world, Chang (2007) concludes that once the advanced capitalist countries secured core status in the world economy, they "kicked away the ladder" to ensure other countries could not follow.

Concluding Remarks

The distinction between NDCs and developing capitalist countries is then one of power, wed together by imbecile institutions, and fortified by the institution of private property. It is a return to the powerful Veblenian understanding of institutions and the role of private property as a power relation. In making such a return, Chang's International Political Economy (IPE) opens a powerful door for policy that includes gender as an analytical category, as it allows emphasis to be placed on individuals, households, and institutions, while enriching and understanding of the way in which these shape one another. Indeed, Veblen wrote much on the subjugation of women both in the household and in society at large. Due to the constitutive nature of institutions, the inclusion of gender is not only compatible with IPE, as it brings equal emphasis to individuals in their cultures and institutions, but would enrich and strengthen it in terms of developmental policy that would otherwise be invisible.

In 1970 Ester Boserup demonstrated the significance of the omission of women in the study of international and development economics, ushering in a wave of literature that has attempted to rectify gender blind analysis. More recently, feminist literature has called for an approach to economics that allows its practitioners to see into the "black box" of the household. Numerous authors have cataloged male-biased development policy and its consequences, including the inability to accurately assess the true impact of macroeconomic policies aimed at increasing efficiency as long as the unpaid portion of the labor force is invisible. (See for example Elson, Grown & Cağatay, 2007.) Though this paper does not attempt to develop an IPE that encompasses gender as an analytical category, having established the connection of Chang to Veblen, this can be seen a useful undertaking for future research. As James T. Peach argued, Institutional economics is itself an institution (Peach, 2001). As such, it is critical that power relations at all levels of analysis are challenged.

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THE CAPITAL DEBATES AND MAINSTREAM POLICY ADVICE:

A CASE STUDY[1]

Abstract

The global crisis of 2007 has shown the limitations of the mainstream approach. We trace the origins of the limitations of the dominant neoclassical views to the capitals debates and to the rise to dominance of intertemporal general equilibrium. We use the International Monetary Fund (IMF) as a case study of this perplexing continuity of policy advice. Given our survey, we conclude that even though the economy was in the midst of the worst capitalist crisis since the Great Depression, a significant paradigmatic shift in economics is extraordinarily unlikely.

Introduction

Economic theory has been in a state of crisis since the 1960s. Nevertheless, the ability of mainstream economists to provide policy advice has been left wholly undisturbed. The nature of this crisis is seldom noticed, given that most economists are utterly unaware of its existence. At present, most economists assume that the aggregative

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macroeconomic model presented to undergraduates and underpinning most policy advice by professional economists is incontrovertible. Where there is a vague notion of the limitations associated with the idea of aggregate capital, brought to light during the so-called capital debates of the 1960s, it is presumed that these issues have been satisfactorily dealt with by the disaggregated Arrow-Debreu General Equilibrium (GE) model.

In this sense, the capital debates, having left unaffected the foundations of mainstream economics, are a mere curiosity and should be relegated to a footnote of the history of economic analysis. However, contrary to this widely shared narrative, the capital debates brought about significant theoretical change in the mainstream, and, in fact, the failures of the conventional theory revealed in these debates in effect produced the authority of Arrow-Debreu intertemporal general equilibrium in mainstream theory. What is striking about this theoretical shift is that at the same time the capital debates proved simple parables of relative prices determined by scarcity and driving allocative choices generally invalid, admitted by Paul Samuelson, economic theory became dominated by an unrelenting neoclassical model that celebrates the potential efficacy of unencumbered markets.

It is thanks to the unassailable nature of the Arrow-Debreu model, from the neoclassical point of view, that the defense of market fundamentalism sprang to the policy arena in the 1970s. In this way, the ascendancy of the Arrow-Debreu model following the capital debates is as substantial a factor as the repeal of the Keynesian consensus is to the methodological and sociological shift that occurred in the profession in this decade. The rise of the rational expectations hypothesis, the development of the efficient market hypothesis, and the relegation of heterodox economists to the margins of the profession (e.g., by denying tenure, or constraining the ability to publish in the same journals) emerge in this sense as a direct result of the capital debates and subsequent adoption of the Arrow-Debreu notion of equilibrium.

Arrow-Debreu provided an authoritative attestation that markets are, in some sense, efficient. *Roma locuta est, causa finita est*; Rome has spoken and the debate is over. It is for this reason that no significant change in policy advice, comparable to the theoretical change, took place. The theoretical model is logical, but it is not directly useful for policy analysis; the aggregative model is, on the other hand, is readily available for empirical application – even if the evidence is sometimes contradictory – but lacks logical consistency. Since mainstream economics is either logically defective or flatly irrelevant, we conclude that it is authority, rather than logic or empirical evidence, that provides the basis of mainstream policy advice.

The remainder of the essay is divided into three sections. The following section describes the main elements of the capital debates and how the issues raised led to the rise to dominance of intertemporal general equilibrium. The subsequent section expounds upon the limited use of the Arrow-Debreu model in terms of policymaking, and demonstrates the persistence of policy guided by the aggregative model. In the last section, the International Monetary Fund (IMF) is used as a case study of this perplexing continuity of policy advice. Given our survey, we conclude that even though the economy is in the midst of the worst capitalist crisis since the Great Depression, a significant paradigmatic shift in economics is extraordinarily unlikely.

The Return of Vulgar Economics

The capital debates remain a puzzling chapter in the history of ideas. Nearly everyone accepts that the British (as opposed to the Massachusetts) Cambridge won the debate, something Paul Samuelson acknowledged early on.[2] Yet no one seems to grasp the full implications and relevance of the debate itself. Typically it is assumed that the capital debates relate simply to problems of aggregation, and that the use of aggregate production functions and aggregative measures of capital is still justifiable, for simplicity's sake. However, contrary to this viewpoint the capital debates did not rest upon the possibility of building aggregate measures.

The capital debates are associated with the very notion of capital. Classical political economy authors, from William Petty to Karl Marx, including Quesnay, Smith and Ricardo, treated the process of production as a circular one. In this context, capital is a produced means of production,[3] rather than a factor of production used in the process of obtaining final goods. The most important result of the capital debates is that, once capital is defined as produced means of production, there is no direct relation between the relative abundance or scarcity of the means of production and its remuneration. Distribution, in other words, is not governed by supply and demand.

Since the Marginalist Revolution, and the rise of the so-called neoclassical

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[2] See Samuelson (1966). A typical position is that of Robert Lucas (1988) who notes the victory of the British argument, and yet remains oblivious to the problems of using the aggregate production function in the same paper.

[3] For Marx (1867, p. 189), capital also involved a social relation between the owners of the means of production and those forced to sell their labor power. For him, capital "can spring to life, only when the owner of the means of production and subsistence meets in the market with the free laborer selling his labor-power."

school, the notion that relative prices are determined by supply and demand, and that these reflect the relative abundance or scarcity of all goods and services – including factors of production – gained consensus. As a result, the supply and demand for capital became the determination for the remuneration of capital. The more abundant is capital, the lower its remuneration, and vice versa if it is scarce. Conflict has no role to play in the determination of distribution, and social classes vanished entirely from analysis.

Additionally, substitution leads to the full utilization of resources and their optimal allocation. If capital is scarce and expensive, and labor abundant and cheap, economic agents substitute labor for capital and fully utilize labor. Thus, despite the abundance of labor, its relative cheapness, through the principle of substitution, leads to full employment. Indeed, unhampered markets *do* lead to the veritable best of all possible worlds.

It is the logic of the principle of substitution, based on relative scarcities, that the capital debates shattered. Contrary to the neoclassical parable, the capital debates showed that it is not generally possible to obtain an univocal relation between remuneration and relative scarcity. For example, assume that we have two commodities produced with capital and labor, and that one can be said to be univocally more capital abundant than the other. In this case, as capital becomes more abundant the profit-to-real-wage ratio will fall, more capital will be used, and more of the capital-intensive good will be produced. However, it is possible that one good will be more capital intensive at high levels of the profit-to-real-wage ratio, and that the other becomes the capital intensive good at lower levels of the same ratio. That is, we would have factor intensity reversal. In the instance of factor intensity reversals, the conventional relation between factor scarcity and relative prices breaks down.

In this situation, it would be possible that as the profit-to-real-wage ratio falls, more labor will be used, and more of the labor-intensive good will be produced. In other words, there would be reverse capital deepening and a lower rate of profit associated with a reduction in the use of capital. Substitution moves in the wrong direction, so to speak, and more of the scarce factor is demanded. The implications for neoclassical theory cannot be overstated. First and foremost, there is no relation between relative scarcity and the remuneration of factors of production, and, as a result, distribution is not simply the product of market forces. Further, there is no guarantee that all resources will be fully utilized.[4]

It must be noted that, even though the capital debates are fundamentally about the logical coherence of the neoclassical approach, the results of the capital debates have important empirical implications. Neoclassical theory makes strong predictions vis-à-vis substitution effects and the relation between relative scarcity and remuneration. Yet the capital debates suggest that some of those predictions might not be consistent, and, as a result, the absence of those relations might be expected in the real world.

The most obvious prediction is the inverse relation between investment (capital intensity) and the rate of interest (its remuneration). As it is well known, there is little evidence that investment is sensitive to variations in the real rate of interest. In a rare

[4] Both results are important, for example, for the Keynesian possibility of unemployment equilibrium. Keynes' (1936, p. 243) emphasis on the unimportance of the natural rate of interest not only implies that the supply and demand for capital (loanable funds) do not determine the equilibrium rate of interest, but also that the conventional rate of interest may be set at such a level that brings about persistent unemployment.

survey of the empirical literature on the determinants of investment, Robert Chirinko (1993, p. 1906) argues, "[T]he response of investment to price variables tends to be small and unimportant relative to quantity variables."[5] Similar results are obtained by Heim's (2009) more recent study. In other words, interest rates have little effect on gross capital formation, and the substitution effects that imply that agents use the cheaper factor of production are not operative. Further, the empirical evidence suggests that investment reacts to quantity variables, meaning the level of activity. This suggests that the income effects tend to supersede substitution effects and that a firm facing less demand will not buy capital goods, even if the interest rate is low. These results underscore the empirical relevance of the capital debates.[6]

Similarly, the capital debates highlighted the futility of using the aggregate production function to measure the growth and productivity performance of real economies. The theoretical problems with the aggregate production function, associated to the notion of capital as a scarce resource, are compounded by the impossibility of disentangling it from the identity of income with the structure of the functional distribution of income (Felipe & Fisher, 2003). In other words, if one runs a regression of income on capital and labor, as is often done by those using a production function, it

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[5] In a recent empirical study Atesoglu and Emerson (2008, p. 1051) claim to find support for neoclassical models while arguing that "the effect of R [real interest rate] on I [investment] is always positive (sic)," for the American economy.

[6] In the same way, the empirical evidence seems to contradict the notion that higher wages would lead to substitution of cheaper factors of production for labor. The exemplary case is the well-known study of the fast food industry in New Jersey, which found a positive correlation between the minimum wage and employment (Card & Krueger, 1995).

by definition the wage multiplied by labor utilized in production plus capital multiplied by its remuneration.

In this way, the capital debates leveled the theoretical foundations of neoclassical economics, and provided significant empirical evidence that neoclassical models and their resultant policy prescriptions should be viewed with a healthy measure of skepticism. Faced with the impossibility of using both the notion of aggregate capital and the principle of substitution, neoclassical economics opted to apply the principle of substitution to each kind of capital good taken as a distinct factor of production, by using the Arrow-Debreu model of intertemporal general equilibrium (Garegnani, 1976; Milgate, 1979). Even though the idea of treating capital as a vector of heterogeneous capital goods was first developed by John R. Hicks in the 1930s, and used by Arrow and Debreu in the 1950s, it was only after the capital debates that it came to be dominant within the mainstream.

The problem with the use of heterogeneous capital goods is that it implies a change in the traditional method of economics. Normal equilibrium positions are associated with a uniform rate of profit; however, when dealing with heterogeneous capital goods that are not substitutable between each other, it becomes necessary to discard the notion of long-run equilibrium. In Arrow-Debreu models all prices are short-run prices, associated with differential rentals for each capital good, and any change in the data of the system – preferences, technology, and information for given initial endowments – affects the direction to which the economy adjusts (Petri, 2003). In other words, the forces of competition that lead capitalists to those sectors with higher remuneration and establish a uniform rate of profit do not operate in the Walrasian world.[7] Hence, the Walrasian models are incapable of ascertaining tendencies in real economies, a defect that is not mitigated with the introduction of imperfections (Stiglitz, 1993, p. 109), which Stiglitz calls the post-Walrasian and post-Marxist paradigm. Far from increasing the realism of the model, the casting about of such lifelines only complicates the results of an exceptionally unrealistic one.

Information imperfections, and other related imperfections such as price rigidities or lack of rationality, once introduced leave the Arrow-Debreu model unable to produce Pareto efficient solutions, or even market equilibrium, since some markets may not exist. Additionally, the introduction of imperfections renders the aggregative model prone to suboptimal outcomes. Suboptimal results in the presence of imperfections suggest that in their absence markets would still produce optimal outcomes.[8] Some authors tend to confuse the imperfectionist arguments, and the implicit support that they provide for policy intervention, as a break with orthodoxy. Although it is clear that they provide space for flexibility in policy advice, they remain firmly based on orthodox grounds.[9] The

[7] That GE models do not support the notion that the abundance of a factor of production will be associated with lower remuneration has been pointed out by a survey of those models (Bliss, 1975).

[8] The same is valid for Bowles and Gintis' (1993, p. 84) notion that market exchanges are usually contested and endogenous enforcement costs are not zero, and, as a result, there are conflicts of interest among exchanging parties. Therefore, if enforcement costs were nonexistent the Arrow-Debreu results would prevail. It must be noted that all the literature on post-Walrasian economics presumes continuity between the classical political economy authors and the postmarginalist revolution economics, which would mean that there are no significant distinctions between Smith, Marx, Walras, and Arrow. For a debunking of those views see Garegnani (1984).

[9] Colander et al. (2007-8), for example, seem to suggest that several of the post-Walrasian developments can be seen as breaking up with orthodoxy. For a critique see Vernengo (2010).

capital debates, in contrast, showed that unhindered markets free of imperfections of any type, do not lead to market efficiency in general.

Faced with the logical problems that neoclassical aggregative models are riddled with on the one hand, and the irrelevance of general equilibrium models on the other, neoclassical economists did what any rational agent would do: disregard the critiques and in so doing, their deleterious results, and proceed as if nothing had happened. However, an innovative development generated a curious division of labor within neoclassical economics. Aggregative models were deployed for the purposes of teaching and policymaking, while the Arrow-Debreu model became the retreat of neoclassical authors when questioned about the logical consistency of their models. A tradeoff between logical consistency and relevancy was thus formed in the core of mainstream economics.

The degree of fragmentation – as Roncaglia (2005, p. 468) so aptly expresses it – and confusion in the mainstream today is the result of such inconsistency at the core of economics, and not, as is frequently asserted, because of the demise of the Keynesian consensus. The collapse of the certainties provided by the old aggregative neoclassical model brought about an often-cynical defense of market-oriented policies for their own sake. The return of Vulgar Economics, which "sticks to appearances … [and] believes that 'ignorance is a sufficient reason'" (Marx, 1867, p. 336) is complete.

Do the Same, But Expect Different Results

Given the less than paltry theoretical change in neoclassical economics that the capital debates forced, a comparable change in policy advice would be expected. Yet in the policy arena, the virtues of the unfettered market were extolled with more fervor in the decades following this expedient shift in the conventional notion of equilibrium. Here, we use the International Monetary Fund as a case study of the perplexing continuity of policy advice through discontinuity of policy results. The IMF provides a unique example of an institution dedicated to economic policy and empirical research, which has been attuned with the mainstream of the profession. Hence, significant changes in policy orientation would be expected as a result of theoretical developments that change the basic underpinnings of policy models.

Countries facing balance of payment difficulties receive financing from the IMF in installments, conditional upon meeting such performance criteria as outlined in the country agreement. The IMF compendium of macroeconomic stabilization techniques endures more or less in its original form as developed by IMF Research Director Jacques Polak in 1957 (Pieper & Taylor, 1998). Its *modus operandi* for hitting inflation and output targets consists of doctoring the exchange rate and austere fiscal and monetary measures. The former typically entails devaluation and opening up capital accounts of the balance of payments, whereas the latter involves maintaining high interest rates and reducing the debt-to-GDP ratio, with price stability as the overarching goal. The philosophical underpinnings of all policies made by the IMF are the efficacy of free markets, making liberalization the antecedent for most policies.

The performance of IMF guided policy makes this unbending nature of policy advice puzzling, at best. The historical incongruity between promised results and actual outcomes would suggest that empirical observation plays little to no role in informing policy makers at the IMF. Pieper and Taylor (1998) survey the effects of Structural

Adjustment Programs (SAPs) across nations, demonstrating a mélange of results. In many cases, the economic consequences that come at the heels of these programs are the very failures liberalization professes to circumvent. This is not a tragedy of coincidence; the assumptions that permeate neoliberal strategy tend to be at odds with economic reality. As they point out, the macroeconomic model developed by Polak "presupposes that reducing the fiscal deficit automatically leads to a lower trade deficit with no effects on output. Such projections frequently turn out to be false" (Pieper & Taylor, 1998, p. 41). Even with the assumption that output and employment tend to their natural levels, when implementing drastic cuts in fiscal spending in tandem with a sharp reduction of imports, the upshot is a policy-induced recession.

Stagflation is not uncommon in countries made to comply with IMF conditionalities, as SAPs typically contain contradictory policies, and exchange rate adjustment proves far thornier in practice than in theory. Historically, devaluation has produced mixed results, whereas fixed exchange rates, which tend to feature in many IMF programs, have succeeded in reducing purchasing power for workers and increasing labor costs in sectors that produce traded goods. The result, as witnessed in Argentina, is anything but anti-inflationary (Weisbrot & Ray, 2010). Often carried out alongside devaluation is the removal of capital controls, provoking price *and* output volatility, as the exchange rate becomes an asset price for speculative international finance. In spite of such patent policy failures, SAPs and other country agreements changed very little, if at all, throughout the 20th century. Pieper and Taylor (1998, p. 41) remark that while the general accord has shifted away from more extreme positions, "[t]he essentials, however, have not changed."

Perhaps the only consequence of such a perseverant mismatch between policy forecast and outcome was declining pertinence – a reality Dominique Strauss-Kahn was privy to when he came in as the Fund's managing director in 2007. As he said just before being named the new managing director, “What might be at stake today is the very existence of the IMF … the two main issues are relevance and legitimacy” (as cited in Weisman, 2007). As the financial collapse that originated in the United States spread to the rest of the world, many of the poorest countries were made increasingly vulnerable to balance of payments crises. The IMF’s feudal horn sounded once again as it brokered packages for Hungary, Iceland, Pakistan, and Ukraine. The news media declared the IMF back in business, leaving legitimacy the only difficulty for the IMF to surmount. The result has been a slew of papers and statements ensuring the public that today’s Fund is friendly, flexible, and rethinking macroeconomic policy (Blanchard, Dell’Ariccia, & Mauro, 2010).

In January 2008, Strauss-Kahn advocated “timely, targeted, and temporary” counter-cyclical fiscal spending in the *Financial Times.* As is the custom, there is a caveat. Only nations with low levels of debt should employ fiscal stimulus, and, as always, monetary policy is “the first line of defense" (Strauss-Kahn, 2008). Provided stable inflationary expectations and a credible monetary authority prevail, countries should make the requisite interest rate reductions before resorting to fiscal spending. Insofar as inflation lies in wait – due to external shocks or a push for higher wages – caution must reside with any decision to use monetary policy. Chapter five in the Fund’s 2008 World Economic Outlook, titled “Fiscal Policy as a Countercyclical Tool,” expounds upon the “three Ts” of fiscal policy with the same admonishment as

Strauss-Kahn's initial statement (International Monetary Fund, 2008a).[10] Accordingly, underpinning the IMF's "new" attitude toward public spending is an unwavering faith in the ability of markets to self-correct quickly.

That the IMF is rethinking policy, rather than revamping or reconstructing it, is visible in the country agreements fashioned over the course of the current world economic crisis. Weisbrot, Ray, Johnston, Cordero, and Montecino (2009) analyzed agreements the Fund made with 41 countries during the current global downturn, including Stand-by Arrangements (SBAs), Poverty Reduction and Growth Facilities (PRGFs), and Exogenous Shocks Facilities (ESFs). Of these agreements, 31 contained procyclical fiscal and/or monetary policies. Fifteen of these agreements contained pro-cyclical policies in both fiscal and monetary measures. Similarly, a study conducted by Molina-Gallart (2009, p. 7) that looks at the SBAs of 10 low-income countries made between December 2008 and May 2009 finds that as the IMF propagates its image as flexible and in favor of pro-poor spending, "this is not what the IMF has been advising, during the very same months, to the world's poorest countries." For these low-income countries, IMF programs maintain tight fiscal policy, and any improvements in terms of flexibility are "timid and exceptional" (Molina-Gallart, 2009, p. 17). Of the 10 country agreements made, all 10 must reduce spending, none can defer debt payments, 5 promote wage bill cuts or freezes, and 5 are instructed to decrease their fiscal deficit.

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[10] Yet even if this diffident posture could be interpreted as a break from IMF tradition, discretionary spending in times of crisis is scarcely novel in conventional economics. In the 1930s Chicago Economics, in objection to Keynes' position that fiscal policy is an elemental tool for sustaining full employment, assigned a role for fiscal stimulus, to be utilized only in economic contractions when monetary tools have become ineffectual (Pérez & Vernengo, 2010).

to hike interest rates and boost the level of their official reserves (Molina-Gallart, 2009).

The double standard between some degree of fiscal flexibility for wealthier nations and fiscal austerity for poorer nations notwithstanding (Weisbrot et al., 2009), stringent monetary policy has proven the rule, rather than the exception for the "new" IMF. As Ilene Grabel (2010, p. 25) notes, "[T]he IMF has been far less flexible with this policy instrument than it has been with fiscal policy." In her survey of the most recent SBAs, contractionary monetary policy emerges as a major component of many country agreements. For instance, in 2008 Ukraine's SBA calls for a reduction in inflation from 25.5% to a mere 5-7% by 2010; Hungary's agreement imposes an inflation target of just 3% by 2010. Correspondingly, the SBA drawn up for Pakistan requires that interest rates be raised by 200 basis points, and the SBAs for both Iceland and Latvia require interest rate increases of 600 basis points (Grabel, 2010). The circumstances surrounding such policy advice in Latvia, which signed an SBA in December 2008, is one of the more stark examples of the Fund trying the same thing, but this time expecting different results.

The agreement contains massive cuts in government expenditures, higher taxes, and wage cuts in the public sector with the intention of extending these to state-owned enterprises. The IMF staff report for the Request for Stand-By Arrangement states that the "effects from these measures, together with the slowing economy, should also lead to substantial nominal wage cuts in the private sector" (IMF, 2009, 19). In all, the Fund considers Latvia's program of pro-cyclical fiscal and monetary policy “appropriately ambitious” (IMF, 2009, 25).[11]

The Fund projects improvements for Latvia and many other countries beginning this year and lasting several years, demonstrating its steadfast faith in V-shaped recoveries (Weisbrot & Ray, 2010). This projection testifies to the IMF’s perplexing habit of proffering the same sets of policies and expecting different outcomes. The belief in the self-adjusting nature of the economy is above questioning; the actual experience is not particularly important in the decision making process.

Acclaim for the pro-cyclical antilabor policies put forward by the IMF was followed by the well-publicized IMF Staff Position Note titled, “Rethinking Macroeconomic Policy,” yet one more piece in its effort to persuade the public that the “new” IMF is all about mitigating the pains of recession (Blanchard et al., 2010). The two main components to receive attention from this paper are, first, a proposal to increase the inflation target from 2% to 4%, and second, a discussion of the permissibility of discretionary fiscal spending in conjunction with automatic stabilizers. That either of these policy amendments were received as a break from IMF tradition is a testament to the tenacity of policy advice, even if it tends not to yield the expected results.

When these policy discussions are read within context, it becomes clear that neither signify departure from convention. The purpose of raising the inflation target is to give countries room that would enable them to cut interest rates in times of crisis. Yet the authors underscore the notion that this should be explored much further before being put into practice. In an interview published in the online *IMF Survey Magazine,* Oliver

[11] For all of its posturing, when Latvia exceeded its IMF target by ending 2009 with a deficit of 7% of GDP, the Fund praised it for its stringent actions that were only possible by providing limited relief to the hardest hit in this recession (IMF, 2010).

Blanchard, the IMF's chief economist, wonders if the limited flexibility many countries felt in their ability to respond the current crisis is enough to "justify setting a higher inflation target in the future" (Clift, 2010). In other words, he is not as of yet persuaded that raising the inflation target, even by 2 percentage points, is warranted.

In terms of fiscal policy, little is new. Discretionary spending has a role to play in recessions, provided debt levels are such that there is room for fiscal spending. At the same time, it is emphasized that countries must aim for lower debt-to-GDP ratios than they had prior to the world recession. While automatic stabilizers are suggested for consideration, progressive taxation and social insurance programs "would be warranted only if they were based on a broader set of equity and efficiency objectives, rather than motivated simply by the desire to stabilize the economy" (Blanchard et al., 2010, p. 15). The preferred approach to this type of fiscal policy is just a small deviation from discretionary spending in crises. These automatic stabilizers would include temporary transfers, flat tax rebates, and cyclical investment tax credits, activated when a determined threshold is crossed. Blanchard suggests an 8% unemployment level as one such possible threshold (Clift, 2010). Reforms along these lines appear "more promising" as they are less costly. To this could be added, ameliorations of this type do not effect a genuine structural and institutional movement away from free markets.

Nevertheless, the authors are apt to alleviate concerns that the IMF is actually rethinking macroeconomics. According to them:

> It is important to start by stating the obvious, namely, that the baby should not be thrown out with the bathwater. Most of the elements of the precrisis consensus, including the major conclusions from macroeconomic theory, still hold. Among them, the ultimate targets remain output and inflation stability. The natural rate hypothesis still holds, at least to a good enough approximation. . . .Stable inflation must remain one of the major goals of monetary policy. Fiscal

sustainability is of the essence. (Blanchard et al*.*, 2010, p. 10).

Not only does the IMFs inflexibility on monetary policy effectively nullify any genuine support for counter-cyclical fiscal policy, and, therefore pro-poor spending, but even the slightest suggestion that policy analysis should be reoriented is defended on the basis of how it acquiesces to the mainstream of economics. Viewed in this light, it is neither logic or empirics the Fund must contend with, but convention.

Concluding Remarks

Economists have frequently argued in favor of laissez faire policy, and the reasons underpinning this position have been more often than not been associated to their ideological perspective. Whenever the classical authors defended the free market, however, it was never under the presumption that it would lead to full utilization of resources or an equitable distribution of income. The free market was typically defended as an instrument of modernization, that is, an institutional innovation of the rising bourgeoisie against feudal obstacles to economic development. It was only with the rise of the neoclassical paradigm that the free market came to be equated to efficiency in the use of factors of production, and a mechanism for the determination of income shares of the same factors of production. With this, free markets ceased to be defended as an instrument of modernization, and instead were propped up as a superior institution in itself. The Great Depression and the Keynesian Revolution sapped the faith in free market policies, but did not attack the core ideas behind the marginalist views of market efficiency.

The attack on the main tenets of neoclassical economics that started with the

Keynesian Revolution in the 1930s and culminated with the capital debates in the 1960s, showed the logical limitations of the marginalist approach, and forced the mainstream into a defensive position. With the abandonment of the old notion of long-run equilibrium, and the adoption of intertemporal equilibrium, the efficiency of markets was not seen as the result of the persistent forces of the economy. If nothing else, the new notion of equilibrium provided a logically coherent notion of market efficiency. Absent solid theoretical foundation, and, oftentimes, empirical support, the persistence of laissez-faire policy could at least be anchored to the authority of intertemporal equilibrium.

The limitations of such a strategy have become increasingly evident. The duplicity of a profession that teaches models known to be logically incorrect, and uses these very models for policy analysis – even when the actual outcomes do not correspond to the expected results according to the prescription – is hard to justify. The role of the social conflicts of the 1960s, the inflation of the 1970s, and the rise of several corporate institutions in the rise of promarket policies have been extensively analyzed. However, the role of the changing attitudes within the economics profession has seldom emphasized the incisive effect that the capital debates had in promoting the revival of the defense of free markets for their own sake.

The current global crisis has shown the limitations of the promarket liberalizing policies of the last few decades, but from our perspective, it will not be sufficient to promote a meaningful revision of the foundations of economic analysis, and the timidity of the IMF rethinking of its policy stance is a good example of what to expect. In the meantime, learning economics at least remains, as Joan Robinson caustically put it, the best way avoid being deceived by economists.

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CONCLUSION

In this dissertation it has been argued that there is a common Institutionalist approach evident in the works of Marx and Veblen, and it has further been suggested that more generally this Institutionalism is compatible with the view of economic life shared by most heterodox economists. This Institutionalism has been contrasted with more recent renditions of “Institutional Economics” to demonstrate why it is essential for well- reasoned economic analysis and effective policy-making (economic analysis that corresponds to the existing state of affairs and not a fictitious economy of unencumbered markets overlaid with institutions) that heterodox economists reclaim the Marxist and Veblenian roots of Institutionalism that clearly place power relations in the center of analysis. An effort has been made to show that the dissonance between Marxists and Veblenian Institutionalists is unnecessary at the level of abstraction presented in the first essay of this dissertation, and, moreover, it is here argued that the rift between these two “schools” is counterproductive to a clear, cogent approach to heterodox economics that can cohesively and ardently challenge the dominancy of neoclassical economic theorizing in academia and the policy-making arena.

The shortcomings of mainstream theorizing itself have also been demonstrated, both in terms of internal consistency and weakness of policy outcomes. The capital debates ushered in an environment of confusion and a splintering of theory within the dominant paradigm, such that heterodox economists are undertaking research and instructing students of economics in a system rife with the revenge of vulgar economics. This trend seems only to have been intensified with the recent capitalist crisis in spite of a mainstream that has advocated increased flexibility in its approach to policy; counter to what many heterodox economists (this author included) had hoped. It is the task of heterodoxy to unremittingly challenge this state of affairs in the modern capitalist system, and in the words of Bortis, to "broadly classify theories so that eventually a loosely structured body of economic science might obtain" (1997, xvi). Here a suggestion for such a classification capable of encompassing Institutional insight as outlined in this dissertation is proposed. There is, thankfully for all involved, no bold call for a theoretical "reinventing the wheel," so to speak. A clear and straightforward framework already exists, but is all too often left out of heterodox discussion.

As mentioned in the Introduction to this dissertation, the conflict between Marxists and Veblenian Institutionalists is only one of many fissures in heterodox approaches to economic research. Such discord also exists among various Keynesian and post-Keynesian "schools" of economic thought. What is needed, this dissertation argues, is a recognition of commonality in underpinning views of economic life, which it has been proposed be simply termed "Institutionalism," placed within an existing theoretical structure capable of incorporating the various views of heterodox economists. As Bortis has it, Keynesian-Institutionalism adds great insight to economic research, but it is not sufficient. The Keynesian contention that full employment is vital to reducing aggressive and counterproductive trade policy that plagues the capitalist world-system "gains its full force only if Keynesian employment theory is combined with a theory of value and distribution based upon the classical

(Ricardian) approach" (1997, xxi).

Bortis, in line with much of the Sraffian literature, calls for a classical-Keynesian broad basis of approach (in the tradition of Smith, Ricardo, Marx, and Keynes) to replace the neoclassical approach (of Walras and Marshall) because it is a more "fundamental" framework that allows for more diversity and historical specificity in investigation. Future research can contribute to this advantageous project for heterodoxy by clarifying this conceptual framework for economic analysis and demonstrating its ability to take into account the institutional and historical specificities of the inquiry at hand.

As is well known, and perhaps best articulated by Garegnani (1984), the strength of the classical model, or "surplus approach" that has origin in Quesnay's *Tableau Economique,* is its great flexibility. Indeed, its use across authors as diverse as Smith, Ricardo, and Marx is a testament to its ability to maintain its integrity while containing differing political outlooks. Important works done by Sraffa, and extended by Garegnani, Petri, Pivetti, Pasinetti, and many others in the classical tradition, highlight this strength by demonstrating its compatibility with various investment and distribution theories. A critical addition to this classical framework is the Keynesian extension, which sets capacity for the system with the principle of effective demand. Multiple authors have developed foundations for a classical-Keynesian, or Sraffian-Keynesian, approach, and have pointed toward the space left open for institutional, cultural, and historical detail, but no development has yet filled this "space" with the Institutionalism proposed here.